

Rock
BUSINESS & COMMERCE

PUBLIC LIBRARY

MAR 17 1951

DETROIT

The Canadian

Chartered Accountant

- Development of Canadian Corporation Income Tax
by J. Harvey Perry
- Foreign Exchange without Tears
by Sidney Turk
- Accounting for Small Law Offices
by John O'Neill
- The Accountant and The Tax Collector
by Vincent W. Scully
- Glimpses at Current Published Reports
by J. D. Campbell
- Increasing the Effectiveness
of the Independent Auditor
by James E. Turner

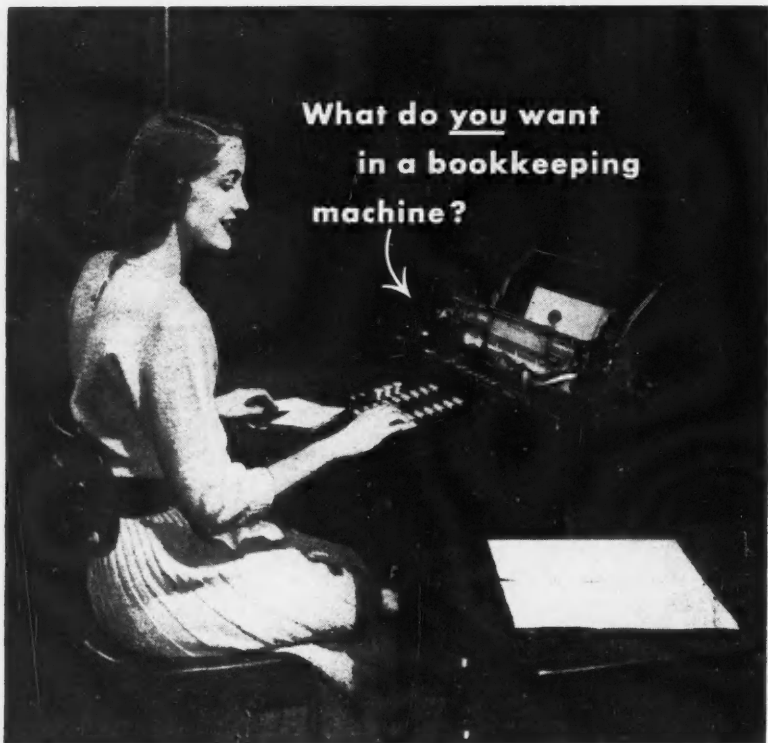


JANUARY

\$5.00 A YEAR

50c A COPY

1951



What do you want
in a bookkeeping
machine?

Most organizations expect three things from their bookkeeping machines:—high production; efficient operation; and quick adaptability to several jobs.

Long experience and many tests have proved that, to get these three basic results, the operator must have a machine with these five features:—

1. Standard adding machine keyboard.
2. Standard typewriter keyboard.
3. Complete visibility of work.
4. Flexibility to change quickly from one kind of work to another.
5. Automatic operations that save time, prevent errors.

The National Multiple Duty Bookkeeping Machine has all these features. Indeed, it's the **only** bookkeeping machine that combines all five in one machine.

With the National Multiple Duty Bookkeeping Machine you can, in a matter of seconds, change from one accounting job to another . . . accounts payable, general ledger posting, payroll preparation, billing, and many other accounting tasks . . . jobs you never before felt you could completely mechanize.

Ask your local National Representative to show you how your firm can effect savings up to 30 % with the National System. Or write to address below.



THE NATIONAL CASH REGISTER COMPANY OF CANADA LIMITED
Head Office—Toronto Sales Offices in Principal Cities



HIGHER ACCOUNTING and ALLIED SUBJECTS taught The SHAW way—the SURE way

Subjects Included In Our Coaching Courses

Commercial Mathematics	Secretarial Practice	Office Management
Commercial Correspondence	Mercantile Law	Partnership Act
Bookkeeping and Accounting	Bank Act	Advanced Accounting
Bills of Exchange Act	Cost Accounting	Auditing and
Dominion Companies Act	Income Tax Act	Investigations
Provincial Companies Act	Bankruptcy Act	Business Organisation
Dominion Winding Up Act	Principles of Economics	and Administration

The student has all the time required by him to complete the course and he has the privilege of consulting the school after the course is finished. Once a Shaw student always a Shaw student.

The student is privileged to consult our instructors in any of his personal accounting problems, even though they may be outside the scope of his course.

Write to Dept. CA for Catalogue and any special information you desire.

SHAW SCHOOLS

Head Office: 1130 Bay Street, Toronto

KI. 3165-6-7

47

ACCOUNTING and RECORD FORMS

Made to Your Specifications

Grand & Toy gives careful attention to every detail. You have a full choice of processes - letterpress printing, photo-lithography, ruling, etc., plus all bindery services.

Next time that you have
a special form call ELgin
6481 or write—

GRAND & TOY LIMITED

"Everything for the office"
SUPPLIES - PRINTING - FURNITURE
6-14 Wellington St. West
TORONTO 1, CANADA
Branches at 322 Bay St. and 115 Yonge St.

WANTED AT ONCE

Accountant to take charge of accounts of a department store, consisting of furniture, hardware, drugs and self-service meat and grocery departments. Single man preferred but, if married, employment can be provided for wife. Passage paid. Housing accommodation available (furnished apartments at \$45 monthly). Commencing salary \$75 per week. Send full details, stating experience, accompanied by snapshot, to Gibbons Company, Hamilton, Bermuda.

OPPORTUNITY

For an experienced chartered accountant, in a professional office in Montreal as assistant to senior partner; good prospects for the right man. Write particulars of experience, salary, availability, etc. to Box 161, The Canadian Chartered Accountant, 10 Adelaide St. E., Toronto, Ont.

PRACTICE WANTED

Chartered accountant wishes to purchase accounting practice. Partnership or agreement for succession will be considered. Box 159, The Canadian Chartered Accountant, 10 Adelaide St. E., Toronto, Ont.

REQUIRED IN VICTORIA

Victoria firm has opening for experienced chartered accountant. Permanent post. Apply Box 160, The Canadian Chartered Accountant, 10 Adelaide St. E., Toronto, Ont.

**PUBLIC ACCOUNTING
POSITIONS IN VENEZUELA**

Accountants with a minimum of three years experience, preferably young and single, who are interested in opportunities in Venezuela are invited to airmail full particulars of their qualifications with one photograph to —

Price, Waterhouse & Co.,

Apartado 1789,

Caracas, Venezuela

Offers to engage men now with public accounting firms will be made only after receiving permission to consult their present employers.

SENIOR AUDITOR

Required with accounting degree to supervise internal audit staff in expanding cooperative association. Position provides good salary plus many employee benefits. Preference given to applicants with related experience and administrative ability. Reply stating age, education, experience, references, salary expected, etc. to Box 162, The Canadian Chartered Accountant, 10 Adelaide St. E., Toronto, Ont.

WANTED

Accounting and auditing practice. Chartered accountant wishes to purchase accounting practice in Toronto. Reply Box 149, The Canadian Chartered Accountant, 10 Adelaide St. E., Toronto, Ont.

POSITION WANTED

Responsible, conscientious, young C.A., executively experienced in retail, wholesale and manufacturing with emphasis on personnel, wants permanent Toronto industrial position. Reply Box 164, The Canadian Chartered Accountant, 10 Adelaide St. E., Toronto, Ont.

**CHARTERED
ACCOUNTANT WANTED**

The Dominion Association of Chartered Accountants requires a chartered accountant to act as administrative assistant and assistant secretary to the Committee on Education and Examinations. Initial salary will depend upon qualifications and experience. Applications, stating date available, and requests for further information should be addressed to the Secretary, The Dominion Association of Chartered Accountants, 10 Adelaide St. E., Toronto, Ont.

HONG KONG

Young chartered accountants wanted for British professional office in Hong Kong. Excellent opportunity to obtain experience with good salary and prospects of steady advancement. State age, marital status, education and experience. Replies will be treated confidentially. Reply Box 165, The Canadian Chartered Accountant, 10 Adelaide St. E., Toronto, Ont.

WANTED

Young chartered accountants required by utilities operating in South America. Plenty of opportunity for early advancement. Foreign service privilege of four months leave with pay at end of three years of service. Pension plan after three years of employment provides protection for family. Applicants should send in complete history of age, marital status, education and experience and should enclose a recent photo. Apply Box 163, The Canadian Chartered Accountant, 10 Adelaide St. E., Toronto, Ont.

The Canadian Chartered Accountant

VOLUME 58

JANUARY 1951

NUMBER 1

Comment and Opinion	1
The Man Who Pays; Sixth International Congress on Accounting; The Accountant and the Tax Collector	
Development of the Canadian Corporation Income Tax	
	<i>J. Harvey Perry</i> 3
Foreign Exchange without Tears	<i>Sidney Turk</i> 15
Accounting for Small Law Offices	<i>John O'Neill</i> 22
The Accountant and the Tax Collector	<i>Vincent W. Scully</i> 27
Obituaries	35
Glimpses at Current Published Reports	<i>J. D. Campbell</i> 36
Increasing the Effectiveness of the Independent Auditor	
	<i>James E. Turner</i> 39
News of Our Members	42
Professional Notes	43
The Students' Department	<i>J. E. Smyth</i> 44

PUBLISHED MONTHLY

By The Dominion Association of Chartered Accountants

R. F. BRUCE TAYLOR, F.C.A., *Chairman, Editorial Committee*

Editorial and Business Offices, 10 Adelaide Street East, Toronto, Ontario

MELVILLE PIERCE, *Managing Editor*

JEAN VALE, *Assistant Editor*

Advertising Representatives: T. G. VATCHER & SON, 67 Yonge St., Toronto, Ont.

Subscriptions to *The Canadian Chartered Accountant* and *The Tax Review*: \$5.00 a year.
Additional subscriptions to *The Tax Review*:
\$3.00 a year.

Single copies 50c. Single copies of *The Tax Review* 50c.

A volume index to *The Canadian Chartered Accountant* is published semi-annually and to *The Tax Review* annually.

Opinions expressed in articles and comment are not necessarily endorsed by The Dominion Association of Chartered Accountants.

Advertising rates on request

Authorized as second class mail by the Post Office Department, Ottawa

(iv)

THE CANADIAN CHARTERED ACCOUNTANT

STEWART, SMITH, MACKEEN, COVERT & ROGERS

Barristers, Solicitors, Etc.

Roy Building

- - -

Halifax, N.S.

ST-LAURENT, TASCHEREAU, NOEL & PRATTE

Barristers and Solicitors

Price House, 65 St. Anne Street

- -

Quebec, P.Q.

GOWLING, MacTAVISH, WATT, OSBORNE & HENDERSON

Barristers and Solicitors

56 Sparks Street

- - -

Ottawa, Ont.

QUAIN, BELL, CARREAU, GILES & GILLIES

Barristers and Solicitors

56 Sparks Street

Ottawa, Ont.

Accounting and Auditing Research Bulletins

- No. 1 A Statement of Standards of Disclosure in Annual Financial Statements of Manufacturing and Mercantile Companies (available in French and English)
- No. 2 A Statement of the Minimum Standards of Professional Practice Which Should Apply in respect of Prospectuses (available in French and English)
- No. 3 The Accounting Treatment of Income Taxes in Some Special Circumstances (available in French and English)
- No. 4. Accounting for Bad Debt Losses (available in French and English)
- No. 5 The Meaning of the Term "Cost" as Applied to Inventory Valuation (available in English)

5 Bulletins and Binding Folder

65c

The Dominion Association of Chartered Accountants

10 Adelaide Street East

Toronto, Ontario

The Canadian Chartered Accountant

VOLUME 58

JANUARY 1951

NUMBER 1

COMMENT AND OPINION

The Man Who Pays

THOMAS Richard Henry, a Toronto Telegram writer, has been quoted in these columns before for his sage remarks under various headings. The following paragraphs appeared recently and refer to a current project of The Hydro-Electric Power Commission of Ontario.

The question is asked: "Who is paying for the hydro frequency change over?"

The answer given in the legislature a few years ago was: "A frequency standardization account was being set up by transfer of monies from the commission's reserves."

Those quotes are either a silly answer to a silly question or a very reasonable facsimile.

From whom could the Ontario-owned hydro get money that it spends for frequency standardization or for any other purpose? — and it comes from this source regardless of the bookkeeping account to which it is channelled or any fancy bookkeeping title that it may be given.

This is quoted because we agree with it; and we recall that we ourselves have been sometimes tempted to say that the art or science of the accountant is, to a considerable extent, the knowledge of which bit of paper to use when making an accounting entry.

Sometimes accountants say that loans are to be repaid out of profits; we

have heard public utilities say that, until rates are increased, current deficits will be met out of reserves; and, from time to time, we learn from corporations that a dividend stabilization reserve is to be set up so that dividends may be left stable despite oscillating annual profits.

We conclude with the broad observation that public utilities (whether publicly owned corporations or creatures of a community) and eleemosynary societies should avoid the use of the word "Reserves" as if it were a plague. For those items which are clearly liabilities or payments received in advance, some other title, expressing much better the true state of affairs, can be readily found. Or to put it another way, the answer to the question "Who is doing what to whom and who is paying for it?" should be obvious from the construction of the financial statement and accompanying footnotes.

The Bank of Canada's Statistical Summaries, when showing condensed balance sheets of groups of companies, give as the last item of "Capital and Surplus" the figure of "Earned Surplus and Surplus Reserves". A footnote explains that this item "includes contingent and general reserves, capital surplus and the refundable portion of the excess profits tax".

Sixth International Congress on Accounting

THE bodies sponsoring the Sixth International Congress on Accounting have announced that the Congress will be held in the halls of the Royal Horticultural Society, Westminster, London, S.W.1 in the week commencing June 16, 1952. Further particulars will be issued from time to time.

The following professional organizations will be hosts:—

- The Institute of Chartered Accountants in England and Wales.
- The Society of Incorporated Accountants and Auditors.
- The Society of Accountants in Edinburgh.
- The Institute of Accountants and Actuaries in Glasgow.

The Society of Accountants in Aberdeen.
The Association of Certified and Corporate Accountants.

The Institute of Chartered Accountants in Ireland.

The Institute of Municipal Treasurers and Accountants.

The Institute of Cost and Works Accountants.

The Accountant and the Tax Collector

AN address under this title by Mr. V. W. Scully, C.M.G., Deputy Minister of National Revenue, Taxation Division, will be found in this issue commencing on page 27. We welcome Mr. Scully again to these pages and recommend to all our readers careful attention to his words.

ANNOUNCEMENT BY THE FOREIGN EXCHANGE CONTROL BOARD

Ottawa, December 6, 1950. — Canadian residents may, in future, accept payment in either Canadian or United States dollars for services rendered to residents of the United States, the Minister of Finance announced today.

Heretofore, Canadians performing services for United States residents have ordinarily been required to obtain payment in United States dollars only. Amendments which have been made in the Foreign Exchange

Control Regulations now permit the alternative of accepting payment in Canadian dollars.

Mr. Abbott stated that no change is being made in the Regulations governing the currencies acceptable in payment for exports of goods from Canada. As in the past, exporters are required to obtain payment in United States dollars for shipments to the United States and other countries in the U.S. dollar area.

Development of the Canadian Corporation Income Tax

By J. Harvey Perry

A historical background
to the double taxation question

ORIGIN OF CORPORATION TAXES

TO begin with we have the fact that corporations are subject to a tax. I think we are entitled to ask why this is so. Why are corporations, as such, taxed separately from the shareholders who own the corporation?

Why a Corporation Income Tax?

Many writers and speakers have advanced profound and impressive reasoning for taxes on corporations. The argument that they are separate legal persons and that some payment should be made for the privilege of carrying on business in corporate form is familiar to all of us. While I have no particular quarrel with these efforts to rationalize the tax I think that without any harm we can spare ourselves a fruitless and frustrating hour of speculation by simply adopting the more realistic attitude that we tax corporations today because our fathers and grandfathers taxed them yesterday. This statement is intended to be neither flippant nor naive. In all seriousness it reflects the fundamental truth that much of our tax structure as we know it today has been inherited from the past. While the incidental furnishings of the

Dominion tax structure get an incredible amount of shifting about from year to year it is still true that the basic architecture of the edifice itself has not altered in some time. The hereditary influence is therefore very strong. Of course, if revenue requirements were otherwise than they are, there might be some possibility of eliminating some feature of the general structure, and the corporation tax might be one to go. But this seems to be a pretty forlorn hope. I think we can all concede that some form of tax on corporations is here to stay.

Where Did It Originate?

If, then, this tax was inherited from our fathers and grandfathers it might be fair to ask where they, in their turn, conceived the idea. One thing is certain — they were not following any precedent in the English tax structure, an assumption which one might fairly make. Generally speaking there have been no special taxes on corporations in England until the last decade and a half, except, of course, the temporary excess profits tax in the first war. The English "profits" tax is now a corporation tax in the real

An address to the Fourth Tax Conference of the Canadian Tax Foundation, Toronto, December 11, 1950

sense, but the standard income tax rate has never been regarded as being of this character.

Old Taxes Inadequate for Corporations

This is not an English importation; it is, in fact, like some of our best football players, an American one. Like many of our other American importations — succession duties, gasoline taxes and retail sales taxes, for example — it found its way naturally across the border because of the proximity of the United States and the similarity of our conditions. The problem that both countries faced roughly 75 years ago was to fit a new economic phenomenon into old and rather inflexible concepts of taxation. This phenomenon was the share company as we know it today, which, in its present widespread form, is almost entirely the product of the last 75 years.

The property tax was the main internal tax source of that time in both Canada and United States, particularly for local governments. Its use was very extensive across the border, where both States and municipalities exploited it fully, although in Canada it was used mainly by the municipalities. This old tax was not limited to real estate as most of us know it today but was a general property tax that applied both to real and personal property. A feature of the Canadian tax which had no particular parallel in the United States was the taxation of income as part of the property tax base. It is not entirely clear as to how income came to be taxed as personal property but the consequences of this feature of the Canadian tax are very interesting and will be discussed below. It was into this framework of a property tax that the American and Canadian authorities, as may be imagined, found it most difficult to fit the multiplicity of businesses in corporate form.

Ontario Railway Commission Views

The general nature of the problem in Canada is well stated in the Report of the Ontario Commission on Railway Taxation of 1905, an extremely useful document to which I will refer again below. The Commission had been set up to study one of the most difficult aspects of this general problem — the taxation of railway property by municipalities. In examining this segment of the problem, however, it stated as follows:

The question as to the most suitable method for the taxation of railways is simply a section, though in Canada today the most important section, of the general problem as to the taxation of economic corporations. The problem of the taxation of corporations is a comparatively new one in Canada, but it is certain to continue to enlarge in importance and complexity, until it far overshadows all other aspects of direct taxation.

A glance over the pages of the official gazettes alike of the Dominion and of the several Provinces will indicate the astonishing growth of corporate enterprise in Canada within the past few years. In this respect we find ourselves following in the wake of the development which has been going on for a considerable period in the United States, and which is still far from showing any signs of abatement . . . On every hand we find corporate enterprise more and more extensively covering at once the older economic fields and the newer enterprises of production and service. In Canada we have every reason to expect that in time the greater part of the capital of the country will take the form of corporate property, and that the individual citizens will hold an ever increasing part of their wealth in the shape of corporate securities, representing either shares in enterprises or loans advanced to support or extend their business.

Inasmuch, then, as the taxes which

are required for the enlarging needs of the public service must be derived from the general wealth of the community, they must be levied in increasing measure upon a constantly expanding range of corporate property or income. For this reason, the problem of corporate taxation has come to represent, if not for the present yet at least for the immediate future, the most important feature of direct taxation.

The Public Attitude

In addition to showing a deeply prophetic insight into subsequent events this quotation illustrates the serious concern felt by tax authorities of the day that the tax base be revised to cope with this new phenomenon — the corporation. Nor was it just the tax authorities who felt this concern. Corporations of an earlier day were notoriously truculent in their relations with governments and often as well with the public. They were usually closely associated too with individuals whose wealth was thought to equal that of Indian potentates and the feeling was general among the public that these wealthy lords of industry and their far-flung empires were not making their fair contribution to the public purse through the existing tax levies.

For several reasons, therefore, it was inevitable that corporations would bear some form of special tax. The municipalities first tried to assimilate them into their general property tax, but gradually added special taxes on places of business, volume of business, at flat rates

and in other forms. The problem was really more than the limited jurisdiction of the municipalities could cope with, however, and the Provinces finally stepped in. Quebec led the way in 1882, and by the beginning of World War I all Provinces were in the field.

The long American experience was borrowed on very heavily. New York and Pennsylvania had taxed corporations separately since the 1820's, and by the 1880's and 1890's had developed a variety of forms of tax, almost all of which were copied by the Canadian Provinces. In terms of present rates the early levies appear quite light, but the taxpayers of the time reacted more violently to them than they ever have since. Two or three cases were taken to Privy Council before the constitutionality of corporation taxes was established and there is at least one instance in Ontario of an influential group of highly respectable corporations who just went on strike and refused to pay an increase in tax. They paid — finally. In fact it got to be quite a regular thing. One writer remarked, with resignation, of this early baptism, "When increases are decided upon it is a case of urgent need for additional funds, and no visible means of getting them except from the corporations".

So much then for the origin of the corporation tax. It was partly the answer to a difficult problem in tax adjustment and partly the product of an age. At any rate there it was, and we still have it with us.

NATURE OF THE TAX

This brings me to the second point — the nature of the corporation tax itself. Here I think there is more cause for comfort than is generally realized. Everyone has been trying hard to make the best of the situation, and over the years some major improvements have been made —

particularly is this true of the last few years.

Early Levies on Specific Bases

In the beginning these levies were all on the so-called "specific" basis. They were payable on branches or paid-up cap-

ital or insurance premiums or miles of railway track or some other factor, and they were paid whether the company made a profit or not. In some cases similar taxes are still levied, and I suppose they can be justified as representing a rough measurement of taxable capacity for some industries. The really significant development in the corporation tax, however, has been the increasing adoption of the profits tax, and the increasing refinements in the basis for calculating taxable profits.

Growth of Ability-to-pay Principle

To the extent that it can be said that a corporation has of itself an "ability to pay" taxes the profits tax comes closest to this principle. We can more fully appreciate this enlightened form of tax when it is pointed out that at one time there were serious doubts as to the feasibility of a profits tax. The Ontario Railway Commission, to which I referred earlier, had grave misgivings on the matter in 1905. They said:

... the real difficulty connected with taxation on the basis of net earnings is a practical one. It is utterly impossible to determine in a permanent and satisfactory way and for all varieties of corporations what is and what is not to be included under net earnings. It is easy enough to specify on general terms what is to be understood by maintenance, operating expenses and fixed charges, but when we come to the concrete items there is no end of dispute as to what should or what should not be included under operating expenses.

We may as well agree that the dispute is still going on, but every so often the dust settles down in an old trouble spot and another problem goes onto the shelf. Furthermore, the immense progress over the last 50 years in the science (or art) of accounting and the increasing familiarity of lawyers with business and accounting concepts have together

contributed immensely to advancement in this field.

The actual milestones in this development were the adoption of a general profits tax by British Columbia prior to the first war, the introduction of a Dominion corporation income tax in 1917, and the general employment of such taxes by all Provinces during the depression and since. I am not suggesting that there is any cause for rejoicing in the additional tax burden these new levies represented but only that if corporation taxes had to be imposed it was a mark of progress that they be levied as taxes on profits.

Recent Marked Progress

Nor has the adoption of profits taxes, as such, represented the peak of progress towards ability-to-pay in this field. Recent years have brought many refinements that represent an ever-closer approximation to this principle. Probably the most significant of these changes has been the granting of the privilege of offsetting losses of certain years against profits of other years. This has meant that ability-to-pay is now measured on a basis broader than simply the accounting of each individual year. In this same class would fall the very significant change inaugurated in 1949 with the adoption of the principle of amortization of capital costs. Stripped of its frills, such as the write-back of excess depreciation and the adoption of the diminishing balance system (this latter appears to have been quite distracting to some people) the great and fundamental value of this change was the adoption of the principle that a cost for a fixed asset may be written off against income under any and all circumstances. Call this an obsolescence allowance, for which business had been asking for years, if it helps any to understand its true significance. Whatever you call it, it represents a tremendous stride

towards reconciling the differences between the tax concept and the business concept of income. Finally, in the same category, I would include the graduation of the corporation tax rate. It also has been geared more closely to ability-to-pay by the granting of the reduced rate to small corporations, and of course has provided an enormous stimulus for the small business.

Mr. J. Harvey Perry was born and educated in Toronto. In 1935 he graduated in Economics and Political Science from the University of Toronto, winning a gold medal and two scholarships. He joined the Department of Finance in 1936 and has specialized in tax matters.

DOUBLE TAXATION

So much, then, for the general background of the origin and nature of the corporation tax. I want to turn now to this intriguing business of "double taxation".

Early Canadian Measures of Avoidance

Taking the long view again, I think we are entitled to ask whether our grandfathers had any appreciation, at the time they were introducing separate and special taxes on corporations, of the sort of problems, such as "double taxation", to which they were exposing us. The really astonishing discovery is to learn that they had some very clear notions about such matters. One of the best statements of philosophical reservations on the new trend of taxation was made by James Mavor, a great Canadian historian and economist. Writing in *The Banker's Journal* in 1900 he urged that there was a real danger in the transparent novelty of the corporate form of business enterprise that the illusion would be created that in taxing corporations we are not taxing individuals. His words were as follows:

In the popular mind while some corporations are associated with certain prominent personalities who may or may not really own any considerable part of the stock, corporations are in general supposed to possess an entity apart from the persons who compose them, and that taxes paid by them are therefore not tak-

en from the pockets of individuals, but are taken from an abstraction whose character is open to suspicion. This illusion is similar in kind to that which is prevalent about the taxation of land, the idea in both cases being that a tax may be paid by a thing and not by a person.

While Mavor's fears appear to have been subsequently realized to the full, there is ample evidence that in actual practice at the outset extreme pains were taken to avoid double taxation if at all possible. This is revealed most sharply in the focus of the municipal property and income tax. Here it was the universal principle that if personal property of a corporation had been taxed then the shares of that corporation and the income from those shares would be exempt in the hands of the shareholders from further personal property tax or income tax. Alternatively if the corporation were exempt on its personal property or income then the reverse followed in the case of the shareholder. One or other version of this principle appears in every Province. Under the municipal income tax in Ontario, probably the best developed of all the municipal taxes, dividends from corporations were entirely exempt as a matter of principle, and the 1905 Commission on Railway Taxation, earlier mentioned, approved of this practice in the following quotation:

When the income of a corporation is made subject to taxation the dividend or

income of private individuals from stock held in such corporations is exempt from taxation, in other words, the income is assessed to the corporation, not to the shareholder.

British Columbia, the jurisdiction having the longest experience in the direct taxation of incomes, entirely exempted dividend income received by individuals from British Columbia companies. Only in the 1930's were dividends made subject to a new graduated surtax, something after the English system, and in this "English" sense the last British Columbia Income Tax Act, suspended only in 1940 under the Dominion-Provincial tax agreement, provided for the removal of "double taxation".

1925 Change under the Dominion Income Tax

Turning to the Dominion field, it is well known that at the outset the *Dominion Income War Tax Act* excluded dividend income from taxation at the normal rate. Since the normal rate was substantially the same as the corporation income tax this meant that there was no double taxation of dividend income, or only partial double taxation when the rates differed. This situation lasted until 1926, when the privilege was withdrawn. In that year the whole individual income tax rate structure was overhauled and, effective for the year 1925, a single graduated rate structure was substituted for the previous normal tax plus graduated surtax. In making this change-over the special treatment of dividends was dropped. This may have been the result of the purely mechanical difficulty of giving an exemption from a graduated tax which had been easy under a small flat tax. It appears from a reading of Hansard that the government defended the measure on other grounds, however. In the debates on the Bill in May and June, 1926, the Minister of Customs and Excise, speaking on behalf of the Minister of Finance,

offered as an explanation for the change that it had been made in response to general requests from the public that earned income be taxed lower than unearned income. He said that the government had not been able to find a satisfactory method of achieving this result but had felt that at least a step in the right direction would be to put the two forms of income on an equal basis, that is, to tax dividends as heavily as earned income. He also argued for the measure on the principle of ability-to-pay, contending that a person receiving \$10,000 in dividends was just as able to pay full taxes as a person receiving \$10,000 in salary. Formerly \$620 had been paid on \$10,000 salary and \$116 on \$10,000 worth of dividends, and the government did not feel that this was right. Such criticism of the change as there was in Parliament was along the traditional lines that the move would drive foreign capital away from Canada.

Attitude of Canadian Business to Change

There is ample evidence that the business community in Canada regarded this change as of grave concern to itself. In reviewing the 1926 budget before the Canadian Tax Conference of the Citizens' Research Institute in 1927, Mr. Hugh MacDonald, then solicitor of the Canadian Manufacturers Association, said:

The most drastic change was that which cancelled the exemption from normal tax of dividends from Canadian companies, the new provisions requiring shareholders in Canadian companies to pay to the full on their dividends, regardless of the fact that the companies themselves have already paid income tax.

He also said:

The Dominion government is to be commended for the reductions in taxation made in the budgets of 1926 and 1927 but it is regretted that dividends

paid by manufacturing companies already assessed in corporation taxes must still pay a second time in personal incomes. It is hoped that the government will see fit to abolish double taxation in the next budget.

Mr. MacDonald returned to the same theme in the following year and expressed continuing hope of impending action. He said:

The question of the taxation of industrial dividends of companies which have already been taxed, and which has been the subject of much criticism remains still unsolved, but we look for some adjustment next session.

In the following year, 1931, Mr. MacDonald was still complaining of the existence of double taxation before the Tax Conference, but undoubtedly his hopes were considerably dampened by the raw blasts of the depression and the discomforting sequel to an actual attempt at a remedy made by no less a person than the new Dominion Minister of Finance, Mr. R. B. Bennett.

Unsuccessful Attempt at Remedy in 1931 Budget

The circumstances of this all-but-forgotten episode are as follows: in his first budget speech of June, 1931, Mr. Bennett, holding jointly the posts of Prime Minister and Minister of Finance, had offered several tax changes. Among these were a new income tax schedule and also a resolution which would have had the effect of exempting dividends entirely from income tax up to half the income of the taxpayer, but not exceeding \$10,000 in any event. Mr. Bennett's own explanation of this change was as follows:

In addition, it is proposed that dividends from Canadian corporations, up to \$10,000, shall be exempt from taxation, to the extent of one-half the income of the taxpayer. In other words, if a man has an income of \$20,000 per annum,

of which \$10,000 is derived as dividends from Canadian corporations, he will not pay a second tax on his dividends, because it has already been paid through the tax paid by the company. That was the law at one time and still is the law in most countries.

Arising out of this and the other tax changes proposed by Mr. Bennett there burst about his head a storm of opposition the violence of which seems to have taken him completely by surprise. An extremely acrimonious debate ensued in the House, the gist of which was that Mr. Bennett had favoured himself and his friends by his proposed tax changes. Mr. Bennett gave a spirited defence of his own personal position but ended up by withdrawing the dividend exemption and most of the other income tax changes as well. His was the last voice to be raised in support of remedial action for many a year to come. Of course, the pressing demands of the depression and the second world war would have overridden any such proposals in any event.

Official Proposals Revived in 1945-46

It is not until the post-war Dominion Provincial Conference of 1945-46 that any further official attention appears to have been paid, at least publicly, to the question of double taxation. Among the Dominion proposals for future tax reforms, designed to adapt fiscal policy as closely as possible to the needs of economic development, we find the promise that steps would be taken to remove double taxation in the event of achievement of a general tax agreement. The hopes for a universal agreement were, of course, not realized at that time. However, the prosperous conditions of the post-war period have made it possible nonetheless to institute what is generally regarded as a very desirable reform. The Government has shown an active desire to remove as far as possible any obstacle to general participation in the de-

velopment of the economy through equity investment. It was felt desirable therefore that at least a start be made toward removing whatever discouragement arises by reason of double taxation.

The 1949 Dividend Credit

Mr. Abbott announced the first step in this direction in his 1949 budget speech. As you all know it took the form of an allowance of 10% against the tax on dividends received from either common or preferred shares from taxable Canadian companies. The effect of this change, stated in another way, has been to reduce the marginal rate applying to dividend income by 10 points.

This particular form of solution is distinctively Canadian. I imagine that anyone who attended last year's Conference

will not have forgotten the long and heart-felt discussion of this particular form of alleviation. The Government was looking for a means of granting relief to Canadian shareholders of Canadian companies and it had to take into account the fact that a great many shareholders of Canadian companies are not Canadians. In short, easily half of the annual dividend declared by corporations in Canada goes to non-residents, mainly Americans. Any relief granted at the corporate level, therefore, for dividends paid out by the corporation would have covered a much wider area than the government felt it was obliged to cover. Through the credit granted directly to the Canadian taxpayer the relief is localized and focussed directly on the taxpayer whom the Government was concerned to assist.

UNDISTRIBUTED INCOME

I pass on now to what I referred to earlier as the problem of "undistributed income". This is a considerably more complicated business than the other three phases and you will have to forgive me if I am somewhat tedious about it.

Nature of the Problem

First of all, I would like to make the point that this is not so much a problem of the taxation of corporations as of the taxation of individuals. Look at it this way. In an economic sense a corporation is a dam in the stream between activities which produce income and the persons who are entitled to receive that income, that is, the shareholder. This is true in greater or lesser degree. We know of some corporations that are modest spillways, but we all know too of the extreme kind of corporation that has completely blocked off the stream. No dividends at all are paid to shareholders and the income is entirely retained in

the business. I am not suggesting any censure here — I am just stating facts. Since this dammed-up income, at least theoretically, must ultimately bear personal income tax, the blocking-off process has two consequences: firstly, it protects the income so retained from exposure to personal income tax in the year earned; secondly, if and when the time arrives that any substantial part of the retained income must be released it is immediately exposed to the usually severe impact of graduated rates. The first result is general since theoretically the possibilities of tax avoidance through retaining earnings is inherent in the corporate structure as such, whether the corporation is widely held, closely-held, large or small. The second result is almost entirely limited to closely-held companies, where usually the death of a principal shareholder requires the withdrawal, if no other steps are taken, of a major part of the accumulated earnings.

Devices of Avoidance

Both these aspects have been the cause of grave concern under our law because of the complete escape of any payment or transaction that can be justified as a capital gain or a capital liquidation. The nature of the corporate financial structure is such that only a fairly simple operation, involving usually no more than a bookkeeping entry, is required to convert what at one moment is an amount of unearned income into what at the next moment is part of the shareholders' capital account. As such, without any contrary provision in the law, the liquidation of capitalized income of this form would be tax exempt. The fascinating possibilities of this and the other mechanisms of escape — particularly the tax free inter-company dividend — have produced a constant war of nerves between the tax administration and the taxpayer. There is an open season here for new and original ideas, and the scope for imagination is almost unlimited. One could also have to concede that in this regard the legal and accounting professions in Canada have not been found wanting in ingenuity. In this rough game the tax administrator can only struggle to keep up, meanwhile relying on such weapons of terror as section 32A and its successor, section 126.

Early Provisions of Dominion Law

Let us take a quick look at the record of the past grapplings with these tough problems. At the outset the 1917 *Income War Tax Act* bravely disposed of the whole problem of tax incidence by providing that every shareholder's income would each year include his proportionate part of the whole earnings of the corporation for the year unless "the Minister is of the opinion that the accumulation of such undivided and undistributed gains and profits is not made for the purpose of evading the tax, and

is not in excess of what is reasonably required for the purposes of the business". For obvious reasons this sweeping and hopeful solution was unworkable, and in 1919 it was converted to the more familiar provision that the undivided profits would not be income of the shareholders unless the Minister was of the opinion that they were in excess of business requirements. This particular revision remained substantially unchanged — and one might add substantially unused — until the last year or two. It was last known as section 9(6).

Disposition of Pre-1917 Surpluses

Another problem that had to be tackled right at the outset was the treatment of pre-1917 surpluses. At first these were exempt when declared in excess of income earned in 1917 and thereafter. In short, dividends paid in excess of post-1917 earnings were exempt from tax. This treatment one can well imagine was productive of all kinds of complications, and was repealed in 1920. At that time it was provided that all dividends declared after December 31, 1919 would be taxable in the year received. This provision was not actually brought into effect until January 1, 1921, however, so that companies were put on their warning and given a whole year in which to clear out the pre-1917 surpluses. No later changes were made regarding pre-1917, and little more need be said about this aspect. It is generally understood that no distinction is now made where a company with pre-1917 surplus on hand declares a regular dividend, except where the company is winding up. In this case the pre-1917 surplus is not taxed on distribution.

1930 Measure of Relief for Post-1917 Surplus

The disposition of undistributed surpluses earned prior to 1917 was only the first of four stages in the treatment

of the general problem. The second came in 1930 when the Act was amended to allow the distribution free of tax of surpluses accumulated prior to the commencement of the 1930 taxation year on winding up, discontinuance, or reorganization of the corporation. This provision remained in effect until 1934, when it was repealed. The Ives Commission in 1945 attempted to ascertain to what extent advantage had been taken of the opportunity it afforded to distribute earned surpluses. It reported as follows: "From the evidence presented to the commission it is clear that many companies did not do so."

Ives Commission Measures

The third stage in this evolution was Part XVIII of the *Income War Tax Act*, enacted in 1946, following the recommendations of the Ives Commission. Under it a private company, at first limited to one having 50 and then later on 75 shareholders, was allowed to pay a graduated tax on its earned income accumulated prior to 1939. The amount on which tax was so paid could then be distributed to the shareholders as a dividend free of any further income tax. This opportunity appeared to have been very attractive to many companies and something over \$50 millions in revenue was collected by the Government under this section.

Need for a Solution in 1950

The real difficulty with both these second and third stages, however, was that neither offered a permanent solution. The 1930 arrangement of free distribution without any tax at all could hardly be accepted in this country as a permanent solution, while the Part XVIII treatment was essentially a device to provide for a block of income. In the meantime, with the increase both in undistributed earnings and in the rates

of personal income tax and succession duties, the problem had become more acute than ever before. It became all the more desirable, therefore, to find a permanent answer. It is believed that such a solution has now been found, and I will deal with it below.

Past Measures to Prevent Avoidance

Finally, there has been what I referred to as the silent war to prevent leakages of accumulated income through one tax-free channel or another. One channel that appears to have been open prior to 1924 was blocked in that year when it was provided that the distribution of property of a company on winding-up, discontinuance or reorganization would be deemed to be a dividend to the extent of its undistributed income on hand. In 1926 one important new avenue was opened, but several others were blocked. The new egress came with the specific allowance of tax exemption for inter-company dividends. The blocking attempts were aimed mainly at capitalizations on a reorganization, reduction, redemption or conversion of shares, redemption of shares at a premium and the lending of money by a corporation to its shareholders. Another provision attempted to block the avenue opened by the new tax-free inter-company dividend by describing a specific kind of transaction that was to be outlawed. These 1926 measures, with some changes, remained the basic protective provisions of the Act until secs. 32(A) and 32(B) were added in 1938. These were tightened up further during the way by Mr. Ilsley, and were succeeded, of course, in the new *Income Tax Act*, by sections 125 and 126 and one or two other protective sections.

1950 — A New Solution

During and after World War II, as I have said, all the trouble spots in this

complex area of relations between corporations and their shareholders were aggravated by the combined effect of further increases in undistributed income, much of it built back into bricks and mortar to produce for the war effort, and also by the sharply increased rates of personal income tax. One would judge that much of the time of the legal and accounting professions in this country has been devoted in the last few years to assisting clients of advanced years who faced what by all counts appeared to be an intolerable situation. It is no secret, of course, not even to the Department of Finance, that ways were being found to circumvent the problem. Most common, of course, was the simple and obvious solution of selling the shares of a company for what they would bring, after the purchaser had made the necessary discount for any potential income tax liability that he might be assuming himself. This was a thoroughly legal transaction, but in many cases was quite understandably a step that was taken with the greatest regret, sometimes involving the sacrifice of family control that had existed for generations. Other remedies were also applied, with which lawyers and accountants are familiar.

This whole problem was brought home so often and so insistently to the Minister of Finance that he felt a solution should and could be worked out. Most desirable, of course, would be a solution that would be permanent, at least insofar as anything can be said to be permanent in this changing world. As a result he introduced in the spring of this year the plan with which I am sure all are by now fully acquainted. The right granted companies having 75 shareholders or less to pay a tax of 15% on their pre-1949 undistributed earnings, and then to capitalize such earnings will in time dispose of the backlog problem. The permanent solution, for the future, of allowing

the same tax to be paid on an amount equal to dividends recommended itself as being fair both to the taxpayer and the fiscus. By this arrangement the taxpayer is given the opportunity of earning the right to pay the 15% rate on the whole of his undistributed income if he distributes half his profits — by all counts a pretty fair deal.

Inter-company Dividends

Once the main hurdle of giving a recognized means of egress for the undistributed income of closely-held corporations had been surmounted it became possible to take two or three complementary steps. Inter-company dividends from subsidiaries acquired after May 10 were blocked except to the extent of earnings following the date of acquisition, but the right to obtain absolute solution through payment of the 15% tax was granted. Verging over to a wider plane, the declaration of stock dividends by any company was classed as a capitalization which called for immediate payment of the 15% rate on the amount capitalized. Of the remaining changes not the least significant was the unlamented repeal of sec. 9(6), which had been just as discomfiting to the tax authorities in actual operation as to the taxpayers.

Mechanism of Capitalization

The mechanism through which the 15% tax operates — that is the privilege of capitalizing undistributed income on payment of the 15% rate — deserves comment. Such treatment differs from that under Part XVIII, where payment of the tax carried the privilege of disbursing tax-free dividends. This change in procedure was due primarily to the problem of segregating *ad infinitum* dividends which carried the 10% credit from those which did not carry the credit, i.e., the tax-paid dividends. This difficulty promised enough complications for

both the administration and the taxpayers to bar the dividend route under the new plan.

Purpose and Effect

One may well believe that this daring and novel experiment was not launched without very serious consideration being given to its general implications. Any Minister of Finance would be gravely concerned lest an action of this sort be interpreted as giving favour towards one group of taxpayers in the community.

In going forward with his bold move Mr. Abbott must have had in mind that in granting the 10% dividend credit, with the promise of increasing the credit in future years, the Government had already embarked on a path which it hoped would ultimately bring an end to double taxation. Here, in connection with undistributed surpluses, however, was double taxation in its most flagrant and destructive form, striking at the very roots of a feature of the Canadian economy that had contributed greatly to its strength — the family business. There was every justification, therefore, for making greater haste in this special case than might be possible generally. Furthermore one must indeed be flinty-hearted to argue seriously that total taxes which, including the Ontario and Quebec 7%, the Dominion 38%, and the new 15% rate, now a total of 60%, are not enough. Add to this that the capitalization route means sacrificing the 10% dividend credit, and also that actual cash withdrawals from closely-held companies are probably made as often as not for paying succession duties on the estate of a principal shareholder, and the total tax load takes on pretty sizeable proportions.

Mr. Abbott no doubt also had in mind

that while the 15% rate was in one sense a commutation of the personal income tax otherwise payable, in actual fact this new rate would mean not a loss of revenue but, in most cases, a clear net gain. It is no secret that in many instances the Government was just not collecting any revenue at all on undistributed income of certain corporations because of the use of the device of a sale or other means of liquidation. No Minister of Finance could find it in his heart, therefore, to be displeased with a tax change which is already producing a revenue of about \$5 million a month. Undoubtedly this flow will not continue indefinitely but it may go on for some months yet. Finally, the proof of the pudding is in the eating. To our knowledge in the Department there has not been one voice raised in anything but praise for this whole programme.

Conclusion

So much for the very general background of the recent corporation tax changes. The more immediate background is probably quite familiar to most of you. I refer, of course, to the general overhauling of the Dominion income tax system in the post-war period — the completely new Act, with the substitution of the rule of law for the Ministerial discretion, the more expeditious appeal procedure through the Tax Appeal Board and the general streamlining and simplification of forms and procedures, which of course is the most appealing of the reforms in the eyes of the public. I don't think it is going too far to say that all these changes taken together have given Canada a modern, streamlined tax structure that is one of the best in the world today.

Foreign Exchange Without Tears

By Sidney Turk

A lucid explanation of what
many consider an insoluble mystery

I HAVE given my remarks the title "Foreign Exchange without Tears" because foreign exchange is really a very simple subject, as I hope to be able to demonstrate. People have the impression that it is complicated. But there is really no magic or mystery about it. Naturally those who have made foreign exchange work a profession do nothing to dispel the aura of mystery which surrounds it. In fact, they do what they can to increase it by throwing in a few technical terms at the right moment when they are dealing with customers. You cannot blame them for that. But stripped of the jargon of the foreign exchange operator and the *gobbledegook* of the economist, foreign exchange is really quite a simple subject.

Establishment of a Foreign Exchange Market

Since I have given a title to my subject, I should also provide a text. This I have selected from the statement issued on the evening of September 30 by the Honourable Douglas Abbott, Minister of Finance, when he said:

It has been decided not to establish any new fixed parity for the Canadian dollar

at this time, nor to prescribe any new official fixed rates of exchange. Instead, rates of exchange will be determined by conditions of supply and demand for foreign currencies in Canada.

The effect of the decision of the Government as announced in this statement was the immediate re-establishment of an exchange market in Canada such as existed before the war. From the time the Foreign Exchange Control Board commenced operations on September 16, 1939, until September 30, 1950, there had been no exchange market, as such, in Canada. During those 11 years all exchange transactions were conducted through authorized dealers and agents appointed by the Board — principally the banks — at rates fixed by the Government. Throughout that period all exchange purchased by these authorized dealers was turned over to the Foreign Exchange Control Board and all exchange sold was supplied by the Board. In other words, the Board through its agents took on all comers adding surpluses of exchange to its holdings or supplying deficiencies from its holdings. Naturally there were very wide swings in the Board's stockpile of exchange according

An address to the Chief Treasury Officers' Association, Ottawa, Thursday, November 23, 1950

to whether the people of Canada as a whole had, on balance, exchange to buy or to sell.

All this was changed by the Minister's announcement of September 30 and I now propose to examine the manner in which, to use his words, "rates are determined by supply and demand" by discussing the organization and operation of the exchange market.

Foreign Exchange, What Is It?

What creates the supply and demand for foreign exchange? Before attempting to answer this question it would ordinarily be pertinent to define foreign exchange. But this is something I am hesitant about doing since in 1946 the Department of Justice virtually decided that there is no such thing as foreign exchange. At that time Justice had before them a draft of the *Foreign Exchange Control Act*. Up to that time the F.E.C.B. had operated under the provisions of an order-in-council passed under the authority of the *War Measures Act* but it became necessary to transform this into an Act of Parliament and a draft was placed before Justice for consideration and vetting. The order-in-council had laid down what residents of Canada are permitted to do in exchange transactions and the words "foreign exchange" appeared quite frequently in the text. The draft for the proposed new Act followed along the same lines as the order-in-council and was cast in very much the same terms. However, the Department of Justice decided that the words "foreign exchange" were indefinable and wherever they appeared in the draft substituted the phrase "foreign currency", adding where appropriate "or a right to any such foreign currency by reason of a deposit". In the end the only places the words "foreign exchange" appear in the *Foreign Exchange Control Act* are in the title and in the title of the Board itself. I have no doubt that

the Department was quite correct and followed the best course from a legal standpoint but naturally, after working for some years under the Foreign Exchange Control Order, the staff of the Board found it rather strange to lose the familiar words "foreign exchange".

In the broader sense Spalding defines foreign exchange as the system by which one country clears its financial transactions with other countries.

Supply and Demand

Coming back to what creates the supply and demand for foreign exchange, economists would answer this question by pointing to the various items in what they call the balance of international payments. This is nothing more or less than a statement built up from the best statistical information available of all the receipts and payments of a country in its transactions with the rest of the world in a given period — generally a calendar year.

The international financial transactions of a country are very similar to the financial transactions of an individual in his own community. If each of us analyzed down to the last dollar all the funds which passed through his hands during the year we should find practically all of the items which appear in the balance of international payments. For instance, in the personal budget of salaried people, the largest expenditures would be for food, clothing, fuel, equipment and goods of all kinds, the counterpart of which in the balance of payments is represented by imports — that is the goods *bought* by a country. In the budget of tradesmen, the major portion of their receipts might come from the *sale* of goods. In the balance of payments the counterpart of this is exports. Goods bought from and sold to other countries eventually cross the border physically and are known as visible trade.

Then in our personal budget there is rent or interest on mortgage (if one is fortunate enough to own a house) the counterpart of which in the balance of payments is shown as interest and dividends. The money you spend on vacations has its counterpart under the heading of tourist expenditures. Sums spent on insurance and transportation appear under the same headings in the balance of payments, the latter sometimes being called freight and shipping. What in a personal budget we should call gifts appear as benevolent remittances and even church contributions have their counterpart under the heading of missionary remittances. These and similar items which represent services rendered by one country to another are known as invisibles.

Then in examining your annual personal finances you might find that you had made payments against the mortgage or made repayments of money borrowed earlier. Or — perish the thought — that you had borrowed on mortgage or from the bank or had lent money to your friends. International items of this kind have their counterpart in the balance of payments as movements of capital.

To continue the analogy, if at the end of the year you should find that your receipts exceeded your expenditures, there would be a corresponding rise in your bank balance but if your expenditures were in excess of receipts, there would be a decline in your bank balance. In the case of the balance of international payments, a country's foreign exchange reserves — including its holdings of gold which, of course, can be turned into foreign exchange at will — rise or fall according to whether receipts exceed expenditures or vice versa. A country's foreign exchange resources, that is its holdings of gold and foreign exchange, may therefore be regarded as its international bank balance.

Mr. Sidney Turk, after serving with the Canadian Bank of Commerce in Toronto, Montreal and Vancouver for many years, joined the Bank of Canada on its formation in 1935 as chief of the Foreign Exchange Division. In this capacity he has also acted as advisor to the Foreign Exchange Control Board since its inception in 1939.

Freedom of Conversion

All the items in the balance of payments — whether visible or invisible trade or movements of capital — give rise to a demand for, or create a supply of, foreign exchange. Ah, but you may say, many of them are not paid in foreign currency but in our own money, Canadian dollars. You may point out, for instance, that interest and dividends due on foreign investments in Canada — both direct investments and holdings of securities — are actually earned in Canadian dollars. This is true, but the foreign exchange regulations have always made it possible for non-residents to convert into foreign exchange out of Canada's official reserves the Canadian dollars they receive from payments on current account including those for goods, freight and other services such as insurance and royalties and, as well, revenue on their investments. While there are still restrictions on the liquidation of certain forms of capital investment by non-residents, it is now the case that conversion into foreign exchange is available for any Canadian dollars actually received by non-residents from the sale of their assets in Canada. Of course in an international sense the debt to the non-resident is not really extinguished until he gets his money back in a form which he can use in his own country, that is, in his own currency.

It is for this reason that where feasible the Control Board facilitates conversion. Mind you, non-residents do not always necessarily ask for conversion. In some cases they leave their receipts in Canada for investment here.

You will have realized that virtually everybody in Canada is at some time or other a buyer or seller of exchange. We do not all engage directly in foreign trade but most of us have occasionally to buy funds for travel purposes or to send as a gift to relatives or friends. And some of us may receive dividend cheques on foreign stocks or gifts from abroad and many small people in trades which cater to tourists take in foreign currency in the ordinary course of their daily business. The greatest buyers and sellers are, of course, the big import and export houses, the transportation companies and the investment firms. The Canadian Government also makes heavy expenditures abroad for various purposes and also has large receipts of foreign exchange including the proceeds of gold refined by the Mint.

Retailers and Wholesalers

When people — individuals, firms, companies and corporations — have exchange to buy or sell they get in touch with the bank. The branch banks are the main *retailers* of foreign exchange. The post office with its money order service is also a retailer but only for the sale of exchange and the same is true of the express companies with their money order and C.O.D. services.

These retailers operate on rates which are supplied by their head offices either in the form of a bulletin despatched by mail — usually through a central branch which services a district — or, in some cases, by wire. But the rates they receive in this manner may be applied only to relatively small amounts — say a couple of thousand dollars or so — and if they

are asked to quote on larger transactions they must obtain a fresh rate from their head office either by wire or telephone.

The Foreign Departments conducted by the banks at their head offices in Montreal and Toronto are, in fact, the *wholesalers* and it is here that the foreign exchange market really exists.

The Market and Its Operation

We have now got to the point where it is pertinent to inquire what the exchange market is and how it operates. Since it is usual to associate the word "market" with a building of some sort it is desirable to say first of all that there is no one building which houses the exchange market. Although there are exchange brokers, unlike the stock exchange these brokers do not meet at a central point to haggle over prices and there is no Board room in which rates are posted on a blackboard as deals are fixed. All the haggling and bargaining is done over the telephone or by fast telegram and cables. The exchange market is, in fact, physically no more than a network of communications linking dealers and brokers in their own offices.

The core of the market is represented by the trading sections of the banks' foreign departments. The function of exchange brokers is merely to act as intermediaries between the different banks and bring buyers and sellers together. It would be possible for the banks to maintain direct contact with each other — particularly since in Canada there are only 12 banks, including the Bank of Canada and the Montreal City and District Savings Bank, operated in the market — but it is found much more convenient to employ brokers, thus cutting down the amount of telephoning necessary to keep in touch to say a tenth of what it otherwise might be. When a bank has business to do it indicates

to the brokers — there is one in Montreal and one in Toronto — the amount of exchange it wishes to buy or sell and the rate it has in mind. The broker then contacts the other banks to try to find one which is interested. When the broker arranges a deal he discloses the names of the principals to each other and thereafter they settle with each other direct. Neither the foreign exchange nor the Canadian dollars paid in settlement pass through the hands of the broker. In fact, the only cash he ever handles is the small brokerage commission, or other fee, he receives for his services. In other words, the broker never buys or sells exchange for his own account or acts as a principal in any way.

As soon as a deal has been arranged it is the duty of the broker concerned to advise all the other banks participating in the market that exchange has changed hands and to let them know the rate and the size of the transaction. In this way all the banks are kept in touch with the level of quotations. The broker does not disclose the names of the principals to the other banks and market deals therefore have an element of anonymity.

The Bank Trading Sections

Suppose we take a look at the way the bank trading sections run their business. If you looked into a trading room you would see that the traders are equipped with a battery of telephones. These would include direct lines to the broker, to one or more of the bank's main city branches, and to the telegraph and cable companies as well as a number of outside lines. In addition there will probably be direct telegraph or teletype connections with New York and with such large western branches as Winnipeg and Vancouver. Through these various means of communication the traders are constantly receiving from their branches and from their correspondents in the United

States and overseas requests for quotations at which they will buy or sell exchange, firm orders to fill and reports of transactions effected.

Constantly checking the market through the broker, the traders give rates for the specific transactions on which they are asked to quote based on the last deal reported. For instance, if the last deal reported in the market was at 5% premium for United States funds or, to express it more correctly, at 1.05, they would probably be prepared to quote for quick acceptance say a buying rate of 1.04 15/16 and a selling rate of 1.05 1/16. As soon as any business is fixed they jot it down on a position sheet. Some of the business fixed will represent purchases of exchange while some will represent sales. The object of the traders is, while protecting their margin of profit, to keep as closely balanced a position as possible. If the position sheet indicates that purchases are in excess of sales they make use of the broker to sell the excess to other banks in the market. Similarly, if sales exceed purchases, they have recourse to the broker to pick up the deficiency from other banks.

To illustrate, if the trader fixes a rate of 1.05 1/16 and sells \$500,000 (U.S.) to a Montreal cotton importer and at about the same time purchases \$500,000 (U.S.) from a Winnipeg grain house at 1.04 15/16, the transactions match off — or marry off as they say in the exchange world — and do not affect his position. He has made a profit of 1/8% and has no need to take any part of the business to the market through the broker. This, however, is the trader's dream. It very rarely happens.

It is much more likely that the cotton importer is a customer of Bank "A" and the grain house a customer of Bank "B". Then you have a situation where Bank "A" is short of United States dollars and requires \$500,000 to cover its posi-

tion while Bank "B" is long and has \$500,000 to unload. Both will cautiously approach the market through the broker and eventually the latter will bring them together. Probably it will be done in piecemeal fashion as neither trader will want to show the full extent of his interest for fear of influencing the rate against himself. Usually trading is done in lots of \$100,000 and traders do not like to expose their hand to a greater extent.

This, of course, is a very simple illustration. In actual practice nearly all of the banks will be operating in the market at the same time and, as their positions are constantly shifting as they fix the rate on transactions at their various branches throughout the country and with their correspondents, it is frequently the case that a bank will be a seller in the market at one moment and a buyer the next.

Fluctuations in Rates

Needless to say, if there are more sellers than buyers the rate weakens, and if more buyers than sellers, the rate strengthens. However, banks may be holding a number of orders that they have been instructed to fill if the rate reaches a certain level and, as the rate declines, it attracts new buyers and, as it strengthens, it brings in new sellers. It is therefore the case that while, to use Mr. Abbott's words again, "the rate of exchange is determined by conditions of supply and demand", it is also true that to some extent supply and demand is determined by the rate of exchange itself. And this is all to the good as the fact that each acts upon the other exerts a stabilizing influence on the movement of the rate.

The Sterling Market

So far I have mentioned only market operations in United States dollars. The

local markets are, however, also quite active in sterling. There is nothing indeed to prevent deals being arranged between banks through the market in the various other foreign exchanges. But in practice such deals are rare. One reason for this is that trade with most countries, both inward and outward, is generally conducted in terms of United States dollars or sterling. The supply of, and demand for, other exchanges is therefore relatively quite small. As a general rule banks obtain their requirements of these foreign currencies — or dispose of their surpluses as the case may be — in New York against United States dollars, in London against sterling, whichever is appropriate to the regulations, or direct with the country concerned against Canadian dollars.

Coming back to the market for sterling, those who have been following exchange quotations in the newspapers will have noticed that the rate for sterling has moved in close unison with that for United States dollars. The ratio between the two exchanges has, in fact, approximated the parity for sterling in terms of United States dollars as agreed by the United Kingdom with the International Monetary Fund, namely, \$2.80 to the pound. That this has been the case has not been due to pure luck or to any phenomenon. When exchange was placed on a fluctuating basis the United Kingdom authorities were, of course, anxious that the rate for sterling in our local markets should reflect the official rate between sterling and United States dollars after allowing for the difference between the United States dollar and the Canadian dollar. The International Monetary Fund too has always taken an interest in the maintenance of what they refer to as "orderly crossrates". Accordingly, after making suitable arrangements with the United Kingdom exchange authorities the Foreign Exchange Control

Board advised the banks that it was prepared to take off their hands any sterling which proved surplus to their requirements and give in exchange United States dollars, and similarly to supply sterling against payment in United States dollars to meet their deficiencies, at the appropriate official rates existing in the United Kingdom. These rates are at present 2.79 7/8 and 2.80 1/8.

Consequently the rate in Canadian markets for sterling can get out of line with official rates for "London on New York" only to the extent of the differential between Canadian and United States dollars. For instance, if United States dollars are quoted in the markets in Montreal and Toronto at 1.05, sterling may range between 2.93 7/8 and 2.94 1/8, but would not move outside of this range. This is the only manner in which sterling transactions differ from those for United States dollars. The operations in the market itself are entirely similar to those for United States dollars. There are active dealings between London and Montreal and Toronto and the trading departments of the banks fill in the market a good many orders received by cable from their correspondents in London.

How the Market Was Established

When the banks were advised on September 30, which was a Saturday, that the Government had decided to withdraw the official rates and allow the level of exchange to be determined by the forces of supply and demand, they did not at first see how a market could possibly spring into being by Monday morning. The machinery of the market had disappeared when exchange control was instituted in September 1939. At that time, as it were by a stroke of a pen, the exchange brokers had been put out of business. Where were exchange brokers to appear from now? Fortunately this

question did not remain long unsolved. In 1939 the Foreign Exchange Control Board had taken on its staff most of the brokers whom its coming into being had dislodged. A request from the banks for the temporary release of one of these experts who was still with the Board, had been anticipated and was readily arranged. This supplied the need for Montreal, and the banks themselves produced an experienced man from their own ranks for Toronto. But given the men, where were they to be housed? Under present conditions how could offices in Montreal and Toronto be obtained at a moment's notice? Eventually the question was asked if the Board itself could possibly lend offices in those cities temporarily for this purpose. This request had also been anticipated and the agreement of the Board to provide offices until other accommodation could be arranged was speedily forthcoming.

But now the third question: without adequate means of communication an exchange market could not operate. How could the necessary telephone facilities possibly be set up in time? Here the Board had to volunteer the information that this contingency had also been foreseen and that the offices it proposed to make available temporarily in Montreal and Toronto were already in process of being equipped with a number of lines. These lines would not pass through the Board's switchboard and while the numbers would be communicated to the banks they would not be listed. They would, therefore, be available exclusively to the brokers and the banks which would provide reasonable facilities until direct wires into the banks' trading departments could be put in by the telephone company.

It was thus the case that at 9 a.m. in the morning of Monday, October 2, brokers were installed in Montreal and Toronto and ready to do business. After a lapse of 11 years the market was open again.

Accounting for Small Law Offices

By John O'Neill, C.A.

The records a lawyer
should keep, and what to record in them

LITTLE has been said or written for some time about the accounting records of lawyers, yet the members of that profession handle substantial amounts of clients' funds and require up-to-date and accurate records irrespective of the size of their practices.

Lawyers generally administer two classes of funds — their own and those which belong to clients. The latter are herein referred to as trust funds. It follows that trust funds shall be kept separate from a lawyer's own funds so that two bank accounts at least are required. Into the trust funds bank account will be deposited moneys held temporarily on behalf of clients such as rents and interest collected or deposits on account of real estate or other transactions. The own account will receive fees earned and from it will be paid office and operating expenses.

To record the financial transactions of a small office the following books and records are usually required. (Suggested rulings and headings are submitted at the end of this article — see p. 24-6.)

Trust Funds

Duplicate Receipt Book

This book records the receipt of all money received for and on behalf of

clients, showing date, from whom received and account to which it belongs. An adding machine tape of the day's receipts will give the total to be deposited. Receipts should be deposited intact. Any small cash disbursements for or on behalf of clients should be made from a petty cash fund which is referred to later.

Cash Receipts and Disbursements

The receipt side of the cash book is written up from the duplicate receipts. It shows the pertinent data mentioned on the receipt as well as the amount deposited.

The disbursement side is usually written up from the information contained on the cheque stubs. It shows date, client, to whom paid and amount.

Trust Funds Ledger

The trust fund ledger contains a sheet for each client and is posted from the information contained in the cash receipts and disbursements book or books.

Fees or commissions earned on collection of rents, mortgages or trade accounts must be transferred from trust funds to own account. Lawyers customarily record income on a cash basis and it is therefore usual to transfer such fees

and commissions to own account when remittances are made to clients. Should remittances be numerous it is suggested that each fee be entered on a charge sheet at the beginning of the client's ledger and one transfer made each month.

General Ledger

The general ledger accounts will be:

- Bank;
- Due to or from own account;
- Client's accounts.

To "Due to or from own account" will be posted a debit for the exchange from the cash receipts and a credit for the fees or commissions etc., as well as small petty cash items disbursed for and on behalf of trust funds. This account will give us the amount to be transferred from one bank account to the other at the end of each month.

Own Account

In order that a lawyer may render a complete and impressive account for his services, the client's ledger must record full particulars of services rendered as well as amounts charged. This information is posted daily from the log sheet or book. Log entries are made by the lawyer, his stenographers and telephone operator.

The sheets are reviewed daily and the particulars to be posted to the accounts are entered in the "Nature of Services" column. Should a tentative fee be set, it is posted in the appropriate column. The information is then transferred to the client's ledger account.

Duplicate Receipt Book

A receipt is issued for all sums received, mentioning date, from whom received and nature of service. An adding machine tape of the day's receipts will give the total to be deposited. Receipts should be deposited intact.

Cash Receipts

This book is written up from the in-

formation contained on the duplicate receipts.

A column for sundry fees is inserted as there are numerous amounts received which do not warrant the opening of a ledger account.

Bank Disbursements

This book is written up from the information contained on the cheque stub. It may contain as many columns as are desired. Expenses are entered when paid and usually office salaries with unemployment insurance and tax deducted are recorded in separate columns. If lawyers are in partnership, a separate column for drawings is used for each lawyer. Frequently, lawyers are required to advance their own funds on a client's behalf. These amounts are recorded in the accounts receivable column and in total are described as "Disbursements on behalf of clients".

Petty Cash Disbursements

This book is to record small cash disbursements necessary to the operation of an office. Frequently, such amounts are disbursed for and on behalf of trust fund accounts. These are recorded in a "Trust Funds" column. The individual amounts are posted to the clients' trust fund account and the total to "Due to or from trust fund account" in the general ledger. Petty cash is kept on the imprest system and as cheques are issued to replenish the fund, they are charged to "Petty Cash" account in the general ledger. At the end of the month, the petty cash book is ruled off and posted to the appropriate accounts in the general ledger.

Accounts Receivable Ledger

The accounts receivable ledger is posted from the information contained on the log sheet, cash receipts, bank disbursements and petty cash disbursements. Its headings and rulings are the same as the clients' account for trust funds. As

Mr. John F. O'Neill, C.A. was admitted to the Quebec Institute in 1934 and to the New Brunswick Institute in 1949. He is resident partner in Moncton of McDonald, Currie & Co., Chartered Accountants.

accounts are rendered, the total for fees is recorded in the tentative fee column as shown in the attached examples.

When payment of the account for fees and disbursements is received, it is entered in the cash receipts and posted to the credit of the account. A fee is then entered on the charge sheet similar to that used for trust funds and posted to the debit of the account thus making the account balance.

At the end of the month, the total of the charge sheet is posted to the accounts receivable control and credited to fees.

General Ledger

The general ledger will contain at least the following accounts:

Assets

Bank
Petty cash
Accounts receivable
Due to or from trust funds
Furniture and fixtures
Library

Liabilities

Tax deducted at source

Capital

Capital
Drawings

Revenue

Fees
Sundry fees
Trust fund fees

Expenses

Rent
Licences
Business taxes
Office salaries
Unemployment insurance
Postage and excise stamps
Office expense

The trial balance prepared from the foregoing accounts will furnish a satisfactory basis for the preparation of interim financial statements.

ACCOUNT RECEIVABLE — LEDGER SHEET

Date	Particulars	Tentative Fees	Debit	Credit	Balance
Aug 12	Account rendered	1200.00			

CASH RECEIPTS — TRUST FUNDS

Date	Client	From Whom Received	Fo	Client's Accounts	Ex- change	Deposit

DISBURSEMENTS — TRUST FUNDS

Date	Client	To Whom Paid	Fo	Client's Accounts	Sundry	Cheque Issued

LEDGER SHEET — TRUST FUNDS

Date	Particulars	Tentative Fees	Debit	Credit	Balance

LOG SHEET OR LOG BOOK

Person	Tel. or Int.	Time			Client	Nature of Services	Tent- ative Fee
		In	Out	Hrs			

The Accountant and The Tax Collector

By Vincent W. Scully, C.M.G., F.C.A.
Deputy Minister for Taxation

The Deputy Minister offers some helpful
advice to accountants in respect to the Income Tax Act

ONE of the simple rules of practice I adopted when I accepted my present job was to look forward. I had heard many things about tax law and administration which were not very flattering, to say the least, and I took the view that in running a large and complex Department one would soon get into pretty deep water if one attempted to redress the real or imaginary errors of the past. Further, I believe very earnestly that it is impossible to stand still — we go forwards or backwards. In these swiftly moving times it is essential to have an open mind and courageous, intelligent lieutenants if progress is to be made. The Department has a splendid leavening of capable people and I am very proud to say that the accountants rank among them with the best.

The administration of our Canadian income tax law falls very broadly into two parts:

1. The determination of the tax, and
2. The collection of the tax.

Comparison with the past or with other countries' practices I cannot make because I know little or nothing about them. For me to say that we have good

legislation in Canada, therefore, means just that I believe so and not that I mean good as compared with any other era or place.

The Roles of Accountant and Lawyer

Since the inception of income tax in Canada, accountants have played an increasingly important part in making the law, in administering it, in advising the public on its many problems and even, in a few cases, in devising ways to evade it. There probably has been a closer tie between the lawyer and the accountant in the tax field than in any other field. This is not surprising, of course, especially as the tax net has spread wider and has at the same time contracted its mesh. The determination of tax, especially in the business world, is substantially an accounting job. Indeed, I think it is fair to say that if all tax returns of businesses were prepared by competent accountants, a great many of the Department's and the taxpayers' difficulties would disappear.

Our lawyer friends have been very generous in conceding us an important role in this field and I would like to reciprocate at least

An address to the Institute of Chartered Accountants of Manitoba, Winnipeg, December 1950

in part by saying that he is a foolhardy accountant who presumes to give a client legal advice on tax matters, even when he is competent and knows what he is talking about. There are very dangerous pitfalls for the unwary, pitfalls that should be easy to avoid if we can clearly understand our own role. Indeed a distinguished Montreal lawyer once said that the lawyer is called in only when an impasse has been reached. This, I would hope, will tend to be the exception rather than the rule. Taxation has become a matter of grave importance to a large proportion of the public. It is not possible to draft tax legislation so that it can be readily understood by the man in the street. If he is a wage-earner, the tax form probably gives him in a fairly simple way all the information he needs to enable him to complete his return. If, however, he is in business he will find the determination of his tax a far from simple problem without help. The Department, of course, does provide such help free of charge. It is given honestly and fairly when asked for. In fact, I know of many cases where taxpayers have been saved large sums by being advised properly at the Department's offices. It is inevitable, however, that there be some absence of enthusiasm in looking to us to help the taxpayer out of his difficulties. In many ways, it is better that he should seek advice from outside the Department. What kind of advice he gets will depend to a large extent on where he gets it.

A Caution to Accountants

Accountants should be most careful in this matter. There are many excuses for the errors made by taxpayers when they valiantly struggle with their own returns. There are few, if any, when they enlist and pay for the services of the professional accountant. I am not at the moment talking about tax fraud

but of perfectly honest people whose knowledge and common sense, for some reason or another, seem to desert them when they are confronted with the job of making out a tax return. I would like to point out a few of the things that disturb us most.

The first, and perhaps the worst, is the assumption that the return will not be carefully examined. This is a very foolish hope and one that has cost taxpayers large sums in avoidable interest charges. You should assume that the return and related statements will be closely scrutinized. This year's may be passed but next year's may not. If there is something wrong, the Department will go back as far as is necessary to get the matter straight.

Secondly, it has never appeared to me that the auditor is doing his job if financial statements are prepared "for tax purposes" rather than in accordance with sound accounting principles, having regard to the nature of the business. I appreciate, of course, the traditional opinion that the taxpayer is entitled to arrange his affairs so that he pays the minimum amount of tax. When profits and tax must be computed for the year, it is sometimes difficult to avoid the "bird in the hand" attitude. There have been many classic examples of smart people outsmarting themselves, however, when grasping out after the maximum advantage.

Thirdly, tentative returns are an anathema. In the Department great strides have been made to speed up the handling of returns and the issue of assessments. Tentative or interim returns are not returns at all. They add to our expenses and they accomplish nothing for an accountant's clients.

Fourthly, hypothetical questions are mutually dangerous. No one in the Department is bound or can be bound by answering a hypothetical question. In

fact, answering such questions is strictly forbidden. Accountants have received answers to hypothetical questions and have then applied them as general rulings. When the case backfires, the Department is unfairly accused of trickery or double-dealing. If you want answers, give us the facts — all the facts — and if it's possible, you will get a straight answer in writing.

Fifthly, remember that the accountants within the Department are just as proud and jealous of their professional status as others are. You will be dealing with them or their successors for years and their respect for you will be measured by the quality of the work you do.

Payment of Tax

On the collection side, perhaps the most prevalent fault is the rather common one of advising clients to pay a smaller amount than will certainly be assessed. This was particularly serious when the Department was far behind with its work. I don't suppose taxpaying will ever be a pleasant business for anyone; income tax is a reasonably fair tax but it would not long remain so if the collection rules were not equitably applied. It has not been uncommon to get appeals, the chief object of which was the postponement of the payment. As you know, the legislation is specific on the point and payment must now be made whether an appeal is lodged or not. This policy will only be varied when the payment of the tax would require the sacrifice of assets and when the taxpayer provides good security. Frivolous appeals are bad on all counts. We receive a great many — especially at those seasons when accountants are just too busy to deal with an assessment when it is received. If you would please remember that it costs just as much to handle a frivolous appeal as a bona fide appeal and that you are contributing towards that cost, we should have far fewer of them.

Mr. Vincent W. Scully, C.M.G., F.C.A. was admitted to the Ontario Institute in 1930 and was elected a Fellow of that Institute in 1947. From 1932 to 1945 he was associated with J. D. Woods & Co. as director and secretary-treasurer. In 1945 he was made Deputy Minister of Reconstruction and Supply, a position which he held until 1948 when he was appointed Deputy Minister of National Revenue for Taxation.

Perhaps I should now touch on a few points in the legislation that may be of interest.

In 1948 the enactment of the *Income Tax Act* marked an important milestone in the development of a national tax system. The *Income War Tax Act*, by reason of the amendments that were added from year to year for 30 odd years, had become a strange and unsatisfactory hodgepodge of afterthoughts, hindsight, and loose phraseology.

Clarity and Precision of Tax Act

It has been said publicly that the introduction of the *Income Tax Act* has materially changed the relationship between the Department and the taxpayer, that the administrative officers have ceased to be time-keepers in a legal game and have entered the lists in a war to the death for the taxpayer's dollar, and this by a practitioner very learned in the law of income tax. I mention this not because I want to enter a controversy but because I feel that some assurance should be given to those who may have been frightened by this alleged metamorphosis. Few laws enacted by Parliament have been given the study and consideration that attended the passage of the *Income Tax Act*. Let it be remembered that Bill 454 — introduced but not debated in 1947 — followed a careful study of

this involved subject by the Senate. It was generally agreed and actively contended that the discretionary powers vested in the Minister by the existing law, the *Income War Tax Act*, should go and that, as far as could be done, the new law should say clearly what it was meant to say. Not being a lawyer, I hesitate to comment on the draftsmanship of the Act but I know, from my personal knowledge, of the care and labour that went into the drafting of the law and also the consideration that was given by the Government and its advisers to the representations that were made on many points before and after the introduction of Bill 454 and in the sessions of the Banking and Commerce Committee of the House of Commons through which the Bill was processed. Perhaps it might be said that there are at least two schools of thought — one of which believes in precise legislation in the administration of which the officers of the Department have no discretion whatever to change the law, and the other of which believes in what is lightly termed legislation along the lines of broad principle which may be interpreted in the way most advantageous at a particular time for a particular taxpayer. As an officer of the Crown with some administrative responsibility, I feel that the clearer and more precise the law is, the fairer is its application and I find in the *Income Tax Act*, as compared with its predecessor, substantial and important progress towards clarity and precision.

Welcome Disappearance of Discretion

You may be surprised to learn that among those who were vociferous in their contentions for legislating out the discretionary powers of the Minister were some who are now puzzled, and baffled perhaps, because the officers of the Department are hewing to the line, administering the law as we believe the legis-

lators intended it should be administered — strictly and impartially.

Of course, it is not for me to defend or decry the legislation. I am merely pointing out that in this so-called game it is difficult and perhaps impossible for the taxing authorities to produce a formula in the form of a statute that could be universally accepted. For our part, we are glad that the discretionary powers have disappeared and we feel that we can carry on with our work fairly and honestly knowing that at least the rules are there for everyone to see — and observe!

Capital Cost Allowances

And now in saying a word or two about some parts of the legislation, I will begin with capital cost allowances.

Accountants, I am sure, must bless the originators of the new depreciation system. As one of those who had something to do with this innovation, I should tell you something of its origin. You will remember that under the *Income War Tax Act*, no depreciation was allowed in the computation of income except what the Minister in his discretion might allow. While there were some generally accepted rates and while the Department's practice was generally understood — especially by the accounting profession — there was still the law which in fact required the exercise of the Minister's discretion every single time an allowance of depreciation was accorded. The new law definitely prescribes allowances in respect of capital cost. Had it been possible to do so, the details that now appear in the regulations formally issued under the authority of the Governor in Council, would have been written into the Act itself. Once issued, these regulations are, of course, part of the law and once they have been stabilized — if that is feasible — probably they should be written into the stat-

ute. It was felt, however, that in fairness to the public, what is largely a question of equitable rates should be set by a more flexible method and I feel sure that at present few practical people would seriously quarrel with that idea.

You know also that an entirely new principle was introduced — the provision that the taxpayer was entitled to recover his capital cost out of profits. This, as far as I know, was new as far as British or American practice was concerned. It was felt that the allowances should not exceed the capital cost and that within fairly broad limits the taxpayer should be free to claim or not to claim these allowances, as his own best interests dictated. How this plan could be implemented in the simplest and fairest way was a problem of great complexity. What was adopted was finally considered to be the most effective method, having regard to the multiplicity of factors that enter into these calculations for several hundreds of thousands of taxpayers. Whatever may be said for or against a declining balance method, the fact is that no other method could be found which combined the important factors of simplicity and fairness and, at the same time, lent itself to expression in terms that could be understood by the average businessman. It may mean lazy accounting, but for thousands of taxpayers complex accounting is not necessarily good nor is simple accounting necessarily bad.

Complaints Few

It is much too early to judge this new system. The Department has had extraordinarily few complaints. Most of these have had to do with rates and since the maximum allowances cannot exceed capital cost, the Department has in most bona fide cases recommended appropriate adjustments in the regulation. No doubt there will be problems that could

not be foreseen. This is the first time in Canada that this important matter had to be clearly laid down for all taxpayers. If there are defects in the system that result in grave inequities or if there are refinements that would improve or further clarify the rules, they will be fully considered by officers who are just as convinced as you are that nothing short of perfection is good enough. I would suggest that the accounting profession should help us in this field by first mastering the rules, by fairly applying them and by bringing to the attention of the Department any points that cause trouble or dissatisfaction.

Inventory Valuation

Inventory valuations are provided for in s. 14 and in Part XVIII, s. 1800 of the regulations. This also was new in the law. Since it is a requirement to compute taxable income for the year, it was felt that any system of averaging profits by inventory manipulation or any device which might tend to transfer taxable income from one period to another by inventory price adjustments would defeat the purpose. Hence the specific provision: an inventory must be valued at cost or at market or at the lower of cost or market. There is no provision under which basic quantities or basic prices or any of the other methods of lowering inventories beyond the lower of cost or market can be employed. This has always been a controversial subject. But it is hard to see how any business can have difficulty under these new provisions, even though the tax advantages which might flow from some other method of pricing are not available.

Undistributed Surpluses of Private Companies

The most recent innovation in this law of ours is the now famous s. 95A. Twice before — in respect of the years

ending in 1929 and again in respect of the years ending in 1939 — Parliament made provision for the relief of private companies. A Royal Commission under the Honourable Mr. Justice Ives had reported on this vexed question. Indeed it seems to have been generally conceded that the prudent businessman who had paid corporation taxes and re-invested the remainder of his profits in the development and expansion of his business, should not be left on a limb from which he could only escape by selling his shares or withdrawing his surplus in bulk at near-confiscatory tax rates.

The previous legislation had been expedient. It provided interim relief but did not make it possible for the owner of a business to chart his future with any confidence as to where he might stand in 1949 or 1959.

The new provision, while similar in character to its predecessor in the field as far as accumulated earnings are concerned, is completely new insofar as its continuing provisions are concerned, and there are a few points which perhaps should be mentioned.

First, there must be an election in respect of *all* the undistributed income on hand as at the end of the 1949 fiscal year. Some companies whose years ended in 1949, before December 31, have expressed dissatisfaction with this — especially when the 1949 part of their 1950 fiscal year was a good one. It would be quite impracticable to depart from a principle that has governed corporations since 1917, and that is that the fiscal year is the taxation year.

Second, there is no election if the tax is not paid as prescribed in the law. There is no discretion here — there can be none and, therefore, if your clients cannot pay the tax, they should not elect, since they will expose the shareholders to serious obligations. This is not the kind of situation that arises when annual

corporation taxes are not paid: the payment of the 15% tax at the time of election is an essential condition of the transaction.

Third, determination of undistributed income must be made before the tax can be paid and, therefore, before the election. It is surprising how many auditors seem unable to make this relatively simple calculation. The Department's officers have been swamped with requests to compute earned surpluses. This obviously is not a job for the Department. The definition is clear and where there is doubt, a reference to the district office will bring a prompt reply. But the accountant should make the calculation. In the vast majority of cases, the calculation should be exactly right. As far as it is possible to do so, the district offices will check the figures immediately but, where there is any doubt in the accountant's mind, he should express it when filing the forms so that the verification can be made before the client has effected an irrevocable distribution which might in whole or in part be taxable.

It is important to remember that this is continuing legislation, assuming that the undistributed income at the end of the 1949 year has been cleared, there will recur the question of 1950 and future years' earnings. This should at least require that the accountant will compute annually and accurately the undistributed income on hand and be in a position to advise his client without the time-consuming research that inevitably results from putting off the job.

Lastly, I should re-emphasize that this s. 95A clearly defines the rules. There is no discretion in the Department to vary them in any particular and, furthermore, there are no time limits which might tend to induce a taxpayer to act without considering carefully his position under the section.

There were other important changes in

the legislation in 1950 that accountants should fully understand.

Limitation on Tax-Free Dividends

Section 27 (subsecs. (1A) to (1F) inclusive) deals with dividends passing from corporation to corporation and limits the tax-free principle under certain circumstances. These provisions are important especially when a plan of purchase or re-organization is being considered and should, of course, in the obvious circumstances, be read in conjunction with s. 95A previously referred to.

Charitable Exemptions

A change of more limited application but of important significance for accountants occurs in s. 57, dealing with charitable organizations. This may look somewhat involved but the simple effect of it is to require so-called charitable foundations or charitable trusts to disburse at least 90% of their income for charitable purposes if the tax-free status is to be held. Donations to charitable foundations or trusts qualified under s. 57 are, of course, allowable under s. 26(1)(a).

10% Rate on Corporation Income

In 1949, a step was taken towards eliminating what has been called double taxation of corporation profits. This provided for a rate of 10% (now 15%) on the first \$10,000 of corporate income and a tax credit to the shareholders of 10% of the dividend received. This was intended to benefit particularly the great mass of small businesses operating under corporate charters. The original definition of related corporations was found to be too restrictive and was changed in 1950 by s. 36(4) and (5). It is important for accountants to be sure, when their corporate clients are claiming the right to be taxed in part at the lesser rate, that they meet the conditions prescribed in this section.

Suggestions Welcome

I suppose it may be expected that the future will see many other changes in the law and practice. Constructive criticism from informed sources will always be given the fullest consideration by the Department and, no doubt, by the Government. It would be well for those who get ideas to remember the importance of thinking a suggestion through. Many of the ideas that reach the Department are discarded because they are impracticable or because they have already been adopted or because the suggester has failed to make clear what he is talking about. I refer particularly to suggestions that have to do with administrative practices. Sad to relate, most suggestions regarding the taxes themselves are unacceptable for perfectly obvious reasons.

Consideration of Amendments

It might interest you to know how amendments to the law are developed. Broadly, such amendments fall into two classes: those that are put forward by the Government in the presentation of the Budget and those that are moved in Parliament during the debates that follow the introduction of the Budget.

Into the first class usually fall all tax changes that arise from Government tax policy. These, as you may suppose, represent high Government policy. The role of the official is to consider such proposals from the technical and administrative points of view and to assist the Ministers in their endeavours to produce practicable and equitable legislation. Apart from the tax policy itself, there are usually many other proposals to be considered. Dozens of individuals put forward ideas that have to be sifted and appraised; organizations such as the Canadian Tax Foundation, the Federation of Agriculture, the Chambers of Commerce, etc. may present to the Minister of Fi-

nance or to the Government important briefs which must be carefully examined. And then, the Department may have proposals. These arise from administrative difficulties, the need for clarification in the law, or the correction of obvious errors. The important thing is that no reasonable proposition is ignored. Indeed, in my brief experience I have been amazed at the care and study which are given to virtually all proposals put forward by people or organizations outside the official family. The Tax Foundation has been especially objective in its approach to tax problems. It has been very gratifying to see how successfully the legal and accounting professions have collaborated in this organization.

Some weeks before Parliament meets, the Ministers of Finance and National Revenue and their chief officers begin meetings to consider the Budget programme. At that time, most of the proposals have had a preliminary screening, have been tabulated and have been studied to the point where they can be explained and discussed. Progressively then the work proceeds until the Ministers have covered the field and have secured the assent of their colleagues to the programme. During this period, new material is constantly coming forward and must be injected into the screening process.

Finally, the Minister of Finance makes his anxiously awaited Budget speech and Parliament picks up the job. This is a somewhat harrowing period for the officials. Many times, when there are important changes in the tax rates or exemptions, critical deadlines must be met with tax tables, or changes in forms or regulations. While decisions frequently have to be anticipated, it is never permissible to release secret data until Parliament has first been informed. It is quite a tribute to the many people who

have been involved in these difficult proceedings that, in Canada, there never has been a leak.

For those who first see the amendment in a tax service or in the Act itself, the work that has gone into its preparation is not apparent. Nonetheless, I feel that you who can appreciate the importance of the result can also appreciate the difficult work that goes into its accomplishment.

While the legislation is before Parliament, the debates are fully publicized and no doubt all accountants keep in close touch with what goes on. During the Committee stages the senior officials sit by the Minister in the House to assist him in dealing with the interrogation he is usually subject to. Amendments are frequently proposed at this stage or during the Bill's passage in the Senate. Sometimes these are accepted and sometimes they are not, but invariably they must be considered and an explanation given to Parliament if the amendment is not acceptable. I need scarcely add how greatly relieved everyone is when the third reading has been approved!

Humours of Taxes

But I must not give the impression that the life of the tax collector is wholly sorrowful or frustrated. There are many instances of humour to brighten our days and even the occasional letter of thanks and commendation. Being human and sensitive, we enjoy such letters. That we are not devoid of the milk of human kindness may best be evidenced by the generosity with which the staff from St. John's, Newfoundland, to Victoria, B.C., contributed over \$12,000 for the relief of the members of our Winnipeg staff who suffered heavily in the tragic flood in that great city last spring.

Considerable progress has been made by the Department in improving its pro-

cedures, simplifying forms, speeding up refunds and assessments, and in reducing its operating costs. But the job of good tax administration is not one that can be carried out by the tax collector alone. We need the cooperation of the public, especially of the professional accountant. If taxation is inevitable, surely it is in the public interest that honest, strict and impartial administration be maintained.

We will do our best and it will be a better best with the help of the accounting profession.

And now in conclusion, I think it might be appropriate to quote a few lines attributed to an American admiral by the creator of the plan for Operation "Overlord". It seems to me that you, the taxpayers' advisers, and we, the tax collectors, might profitably and often remember these words:

"Give us the strength to accept with serenity the things that cannot be changed. Give us courage to change the things that can and should be changed. And give us wisdom to distinguish one from the other!"

Obituaries

William Sidney Ronald

The Institute of Chartered Accountants of Manitoba announces with deep regret the death of William Sidney Ronald in his 70th year. He was senior partner of the firm Ronald, Griggs & Co., Chartered Accountants, Winnipeg.

Born in Toronto, Mr. Ronald spent his entire business life in Winnipeg. Admitted to the Manitoba Institute in 1903, he was disturbed that the charter obtained in 1886 was dormant and determined that this body should become effective. With the assistance of a handful of chartered accountants in Winnipeg, he called a general meeting early in 1906 when he was elected president of the Institute at the early age of 26.

After the first world war Mr. Ronald was decorated by the Belgian government for his work in the Red Cross. He was also a member of the board of governors of the Winnipeg Art Gallery and was active in the Chamber of Commerce. He was a life-long member of the Masonic order.

To his widow and daughter the members of the Institute extend their sincere sympathy.

Sidney E. Nicholson

The Institute of Chartered Accountants of Ontario announces with regret the death of Sidney E. Nicholson at his home in Toronto on November 20, 1950. Mr. Nicholson was born in Bristol, England and came to Canada as a young man. He was admitted to membership in the Ontario Institute in 1925. A partner in the firm of McDonald, Nicholson & Co., Chartered Accountants, Toronto, he had formerly been secretary-treasurer of Sheldon's Ltd., manufacturers of ventilation fans at Galt, and was a past president of the Canadian Fan Association. He was a member of the CARIA and a past president of the Ontario Society of Industrial and Cost Accountants. He was also a member of the Kingsway Kiwanis, the Toronto Camera Club and Trinity Anglican Church, Galt. To his wife and daughter the Institute extends sincere sympathy.

Glimpses at Current Published Reports

By J. D. Campbell, C.A., R.I.A.

Department of Accounting, University of Alberta

A financial analysis of Canadian industrial corporations for 1950

IN carrying out the preliminaries of a financial analysis of Canadian industrial corporations for the year 1950, I have encountered several situations which, at least from an academic standpoint, I consider extremely interesting.

Consolidated Balance Sheets

Throughout the last few years in analyzing financial statements, I have noticed cases in which concerns have either added or subtracted subsidiaries from the consolidated picture. In such cases I found myself unable to utilize data covering balance sheet changes as the changes shown resulted from the attempted comparison of statements which were not really comparable.

I have before me a statement published in 1950 (also applicable to prior years' statements) in which steps were taken to remedy this deficiency and I am certain that anyone dealing with the analysis of financial statements will agree that it represents a distinct step forward in the region of more informative statements from the standpoint of comparative statement analysis.

The consolidated balance sheet of Canada Packers Limited as at March 29, 1950 has a double columnar presentation with column one "Including certain

wholly-owned subsidiaries consolidated in prior years" and column two "Including all wholly-owned subsidiaries".

The presentation of the data in this manner provides balance sheet information in a way which allows an intelligent comparison to be made with the prior year and at the same time provides data for comparison with the following year when all wholly-owned subsidiaries might be included.

The statement of consolidated profit and loss covered the case set out under column one including data for certain wholly-owned subsidiaries in prior years.

I wish to extend my congratulations to this corporation for taking a step to remove one of the hurdles in analysis where the situation outlined existed.

The External and Internal Auditor

The following excerpts taken from auditors' reports appended to the balance sheets of certain Canadian corporations are presented for consideration.

1. "In connection therewith we made a general review of the accounting methods at head office and certain plants, reviewed returns from branches certified by branch officials and examined or tested accounting records and other supporting evidence to the extent we deemed ap-

propriate, but we did not make a detailed audit of transactions."

2. "Our examination included such tests of the accounting records and other supporting evidence and such other procedures as we considered appropriate in the circumstances in respect of . . . Limited and its principal subsidiary . . . Limited. The accounts of other subsidiary companies were examined by the internal auditors of (parent) . . . Limited and we have been furnished with financial statements as at . . . 1950, certified by them, which are incorporated in the accompanying consolidated statements."

3. "In connection therewith we made a general review of the accounting methods without making a detailed audit of the transactions, examined or tested the accounting records of the head office of the company, of its subsidiary and of certain of the principal branches and reviewed the reports furnished by the company's staff auditor on his examination of the records of the remaining branches."

Two major questions arise out of the above examples.

1. If the auditor satisfies himself in his examination to the extent that he can express an unqualified opinion that the statements present a true and correct view, even though he has partly based the determination of that satisfaction on the work performed by the internal auditor, does the reference to the actual procedures followed in arriving at that point add any value to the opinion? Does the reference convey the opinion which is intended, namely, that the auditor has reached the point where he is expressing an unqualified opinion?

2. Is the auditor still in the position where he can accept the certificate of a responsible official of the company in the verification of certain items reflected in the statement when the auditor himself might verify the items in question?

Implications

The following audit report to the shareholders was considered interesting in that certain information disclosed raised distinct doubts in the reader's mind as to just what implications were to be drawn from the data given.

"We have examined the books and accounts of . . . Limited for the year ended . . . 1950. We have verified the cash in banks and the investment securities and the revenues received therefrom." (These items amount to \$4 millions out of total assets of \$20 millions.)

"We have obtained all the information and explanations required and, in our opinion, the attached balance sheet and profit and loss account, based upon certified inventories presented, are properly drawn up so as to exhibit a true and correct view of the state of affairs of the company as at . . . 1950 and for the year ended that date, according to the best of our information and the explanations given to us and as shown by the books of the company."

In the above case, has the auditor limited his verification to the items mentioned and on that basis issued an opinion? What implications would the shareholder be entitled to draw from the statement?

It would appear that in building up prestige and a sense of integrity the profession might consider the creation of certain mechanisms of review within itself, or, as perhaps an alternative, even the creation of a body exercising powers covering this type of situation similar to the Security and Exchange Commission of the United States.

Conservatism in Reverse

It was interesting to note from a recent published statement of a Canadian corporation that the losses of its wholly-owned subsidiary companies aggregating \$120,492.34 had not been taken up by

the parent company in the loss which it itself suffered. This information was set out in small print in the auditor's report to the shareholders.

The question is similar to that raised where items are routed through the surplus statement rather than given greater prominence in either a combined profit and loss statement or as a subdivision of the profit and loss statement. In this particular instance the item is still further removed. It is true that all legal requirements have been met, but are the present legal requirements adequate from the standpoint of providing the shareholder with as informative a statement as possible?

Materiality or Significance

I examined a statement of profit and loss which reflected an amount of \$270,000 as the estimated provision for taxes for the year. In the president's report to the shareholders, a reference was made that an amount of approximately \$5,000

was included in the current provision covering an adjustment of prior years' taxes.

On several occasions I have noticed that relatively small amounts of a similar nature have been relegated to the earned surplus account.

The question is asked as to what constitutes materiality or significance! The profession might give some direction in this matter. The conclusion which James L. Dohr, C.P.A., arrives at in his article, "Materiality — What Does It Mean in Accounting?", in the July, 1950 issue of *The Journal of Accountancy*, is interesting:

"A statement, fact, or item is material, if, giving full consideration to the surrounding circumstances, as they exist at the time, it is of such a nature that its disclosure, or the method of treating it, would be likely to influence or to 'make a difference' in the judgment and conduct of a reasonable person."

BINDERS FOR RESEARCH BULLETINS

Binders to hold the five bulletins published by the Committee on Accounting and Auditing Research of the Dominion Association of Chartered Accountants may be purchased from the Association's office, 10 Adelaide Street East, Toronto, at the price of 15c each.

Increasing the Effectiveness Of the Independent Auditor

By James E. Turner, M.B.A.

Sometimes the public auditor is anything
but helpful from the internal auditor's point of view

FOR several weeks out of every year, the controller's divisions of most companies are besieged with representatives from independent accounting firms engaged in the process of reviewing the company's records for the year. Sometimes the weeks stretch out into months. Since the purpose of the work of these independent accountants is a review of the company's financial position as of the end of a given year, as well as the results of operations during the year, these independent accountants are engaged in checking and verifying records and asking pertinent questions at a time when the regular work of the controller's division is at a peak.

Because the average accounting officer of the company welcomes an independent review of the records under his supervision, very little thought is often given to the fact that the auditors are sometimes anything but helpful during the peak period that results from a company's year-end closing. It is doubtful, however, if an independent auditor ever completes an assignment without inconveniencing some portion of the client's staff. This inconvenience has been accepted by most controllers as being part of the necessary cost of the independent audit.

Undoubtedly, this has been accepted because it is realized that the independent audit must be made at an inconvenient time in order that the auditor's certificate can accompany the official release of the company's financial statements. It is also undoubtedly tolerated because a very large number of controllers have, at some time, been engaged in public accounting work, and consequently appreciate that the independent auditors must necessarily inconvenience members of the company's organization in order to obtain necessary information.

In some companies, considerable groundwork has been laid in an effort to reduce the amount of inconvenience to a minimum. Where such programmes have been carried out, two notable results have been achieved. In the first place, there has been a reduction in the amount of work that the auditors have had to perform, resulting in less disruption of the regular work performed by the client's organization. In the second place, because of less work, the audit fees have been reduced.

Since the cost of auditing work performed by independent auditors generally is charged against the controller's division, that company official should, of course, be more than casually interested

Reprinted from *The Controller*, August 1950

in any programme that would tend to reduce the over-all cost of auditing. Most controllers feel that, in most cases, there is good cooperation between the company's organization and the independent auditors. An analysis of the type of co-operation that exists between independent accounting firms and members of clients' organizations indicates, however, that such cooperation consists primarily of supplying the auditors with information as requested.

As previously indicated, however, the time when the independent auditors may request information may not be a convenient time for the member of the company's organization from whom the information is being requested. Some companies go considerably further in their cooperative relations with the auditors and it is these companies who have found a resulting financial savings.

Schedule the Programme

In order to obtain the best results from the independent audit, the company should closely programme its year-end closing schedules with the audit programme of the independent accounting firm. Sometime before the actual audit commences, a member of the auditing firm in charge of the audit programme should meet with the controller or his assistant for the purpose of defining the relative programmes, for both the auditing firm and the company. The company should indicate exactly when it intends to finish routine journal entries and close its voucher register, its general ledger, etc. A date should be definitely established as to when a trial balance will first be available. The company likewise should schedule dates when detail information will be available for property records, accounts receivable, inventories, etc. Most important, the company must adhere strictly to this pre-arranged schedule.

The company should obtain from the auditors a list of all reports which the auditors will require as part of their work papers. A great deal of time can be saved on the part of the auditors, if, after consultation with the company officials, ways and means can be found whereby certain analyses prepared by the company as basic sheets can be used by the auditors in conjunction with the audit. In some cases, the company may find it feasible to change the content of regular monthly or year-end analyses so that they will meet the requirements of the auditors. In other cases, the auditors may find that they can change their programme to use existing schedules and analyses prepared by the company. By so doing, a large amount of time can be eliminated that otherwise would be required for the preparation of work sheets by the independent auditors.

Inventory Procedures

With respect to the taking and checking of the physical inventory, the company should work up its own programme for the taking of the inventory. This programme, however, should be carefully reviewed with the auditors well in advance of inventory date. A thorough review of the inventory procedures in advance of the inventory date may well reduce the amount of checking, which otherwise might have to be done by the auditors. The programme for releasing materials after the inventory has been taken and checked should be thoroughly understood so that the company's operations are not held up any more than necessary.

As a result of carefully preparing inventory procedures in advance, reviewing these procedures with the auditors and following the procedures without exception, the time required for the taking of the physical inventory and the corresponding checking by the independent

auditors may be substantially reduced. It is important that a part of the inventory procedure preparations be made in advance of the inventory taking so that all inventories of raw materials, work-in-process, finished goods, stores, etc., are neatly arranged in well-planned locations.

Obviously, one of the first requisites to the taking of a good physical inventory is good housekeeping with respect to the items that comprise that inventory.

Another opportunity to reduce the time spent by the independent auditors in detail checking exists in the proper use of accounting procedures and a resulting routine follow-up by the company's own internal auditors. Copies of all existing procedures should, of course, be given to the independent auditors in advance of their audit. Any changes that might be made in these procedures in order to bring them up to date with existing conditions should likewise be provided for the auditors. Copies of all reports prepared by the company's internal auditing organization, as a result of periodic routine audits of various departments of the company, indicating whether or not established accounting procedures are being followed, should likewise be given to the auditors. If these reports are properly done, the time spent by the independent auditors in reviewing such procedures and doing detail checking will be substantially eliminated.

Branch Office Audits

In some cases, it may be advantageous to the company to utilize the work of the auditors in lieu of work by some part of the controller's organization. Recently, my company found it convenient, after preliminary discussions with the independent auditors, to have them do certain detail work at certain branch office locations, which normally would have

James E. Turner is a graduate of Massachusetts Institute of Technology in Industrial Engineering and holds the degree of Master of Business Administration from the Harvard Business School. For the past 12 years he has been associated with Talon, Inc., Meadville, Pa., as treasurer since 1944 and vice president-treasurer since 1947.

been done by the internal auditing staff. In these particular instances, a large amount of money would have been expended in travelling by the internal auditing staff, whereas the independent auditors used one of their branch offices located nearby.

By working with the auditors, we were able to have them follow our own internal auditing procedure and even supply us with a copy of the internal audit questionnaire all completed. This was done at very little additional expense to the company as a portion of the work would have been done by the independent auditors anyway.

Tax Returns

Another place that it has proved advantageous to expand the operations of the independent accounting firm has been in the preparation of Federal and State tax returns. By properly preparing their work sheets in advance, the auditing firm is in a position to prepare the Federal and various State tax returns directly from the work papers at little additional expense. This has eliminated the necessity for having a full-time tax department within the company to prepare returns.

The responsibility for the filing of returns on schedule, including those prepared by the independent auditing firm, still rests with the company. A review of these returns and the preparation of other tax returns has become one of the

functions of the internal auditing staff.

While it is recognized that such a procedure is probably not practical for a very large company, it has definitely proven practical for my own company. Currently, we file over 200 tax returns during the course of a year, at a fraction of the cost that would have resulted had we organized a full-time tax department.

Closing Schedule

By programming in advance the company's closing schedule with that of the independent accounting firm, my own company has found that there has resulted a reduction in overtime on the part of both the public accountants and the company's accounting organization. At the same time, an earlier closing has resulted.

For the last several years, certified

financial statements have been made available to our Board of Directors well before the end of January and the completed published report to stockholders, which includes a certified statement has been released in the early part of February. The total cost of the annual audit by the independent auditors, meanwhile, has reflected the reduction in time spent by them in the course of the audit.

We have found, however, that the programme for coordinating the activities of the independent auditors with the company's accounting organization varies from year to year. Likewise, it will vary substantially between companies. The programme must be tailor-made to fit the individual company as of a given date. This forward-planning requires time. My experience indicates it is well worth the extra effort.

News of Our Members

Consolidated Mining and Smelting Co. of Canada Ltd. announces that Mr. L. G. Toms, C.A. (B.C.), has been appointed its chief accountant.

• • •

Mr. R. J. Taylor, C.A. (B.C.), recently addressed the members of the Victoria Electrical Association on accounting and business problems concerning electrical contractors.

• • •

Mr. George Smith, C.A. (N.B.), has been named chairman of the Board of Directors of the Saint John Chapter of the Society of Industrial and Cost Accountants of the Province of New Brunswick.

• • •

Professor Donald Patton, B.Com., R.I.A., C.A. (Que.), of McGill University, gave

an address to members of the Commerce Department of St. Mary's University in Halifax on the aims and purposes of the Society of Industrial and Cost Accountants recently formed in Nova Scotia.

• • •

The Provincial Bank of Canada announces the appointment of Mr. Lucien Masse, C.A. (Que.), as a director.

• • •

Mr. S. E. Chapman, C.A. (Ont.), has been appointed a director of News-Chronicle Ltd., the company which publishes the Port Arthur News-Chronicle.

• • •

Mr. Howard T. Burrell, C.A. (Ont.), was elected mayor of the Town of Leaside, Ontario in the municipal elections last month.

Professional Notes

ALBERTA

Calgary Chartered Accountants' Club

More than 50 members attended the monthly luncheon of the Calgary Chartered Accountants Club held at the Palliser Hotel on Friday, November 10. The meeting took the form of a panel discussion on Part IA of the Income Tax Act, with Mr. J. G. Simonton presiding. The panel consisted of Messrs. Arthur Maw, Francis Gordon-Cooper, W. F. Anderson and R. E. Waller.

* * *

Mr. Wilfrid Stempel, F.C.A. announces the opening of an office for the practice of his profession at 208 New Embassy Bldg., 111 8th Ave. E., Calgary.

* * *

Christenson, Simonton & Co., Chartered Accountants, announce the removal of their Edmonton office to 4th Flr., Alexandra Bldg., 10173 100A St., Edmonton.

BRITISH COLUMBIA

Mr. Scott McLaren, B.A., C.A. announces the opening of an office for the practice of his profession in the James Block, 608 3rd Ave. W., Prince Rupert.

* * *

Mr. W. L. Turnbull, C.A. announces the opening of an office for the practice of his profession at Rm. 24, 640 Burrard St., Vancouver.

MANITOBA

William Gray & Co., Chartered Accountants, 708 Great Western Bldg., Winnipeg, announce the admission to partnership of Mr. Kenneth E. Gray, C.A.

NEW BRUNSWICK

New Brunswick Students' Society

Saint John Branch

A social gathering of the Chartered Accountants Students' Society of Saint John was held on Friday night, December 8, at the Officers' Mess of the New Brunswick Scottish Regiment. Approximately 50 persons attended the party. Each of the lady guests

received a token rose with the compliments of the society. The hall was decorated with coloured balloons and merriment was promoted with horns, whistles, paper hats, and dancing. Many of those present participated in a bridge tournament which was won by Mr. and Mrs. A. Gray Burnham. The entertainment was topped by a buffet luncheon served at midnight.

The party was planned by William Allwood, assisted by F. M. McCullum, F. M. G. Taylor and J. K. Logan, C.A.

ONTARIO

David Vise & Co., Chartered Accountants, announce the removal of their offices to Ste. 1624, Bank of Nova Scotia Bldg., Toronto.

Ontario Students' Association

The Ontario Students' Association held their annual fall dance at the Palace Pier on Thursday, November 23, 1950. Messrs. P. Stewart and R. B. Mailling were co-convenors of the committee. A number of the members of the senior Council were among the guests.

* * *

Messrs. C. J. Dick, C.A., C. S. Bond, B.A., C.A., W. I. Hetherington, F.C.A., and W. R. O'Loane, B.A., C.A., formerly practising under the name of Robertson, Robinson, McCannell & Dick, announce that the name of the firm has been changed to Dick, Bond, Hetherington & O'Loane, Chartered Accountants, with offices in the Sterling Tower Bldg., Toronto and at 45 6th St., Chatham.

Hamilton and District

Chartered Accountants Association

The Hamilton and District Chartered Accountants' Association held their second meeting of the season on November 28, 1950 and heard an interesting address by Mr. Monteath Douglas, director of the Canadian Tax Foundation, on the subject of "double taxation". Among the head table guests was Dr. D. A. MacGibbon, a member of the Ives Commission.

The Students' Department

J. E. Smyth, C.A., Editor

NOTES AND COMMENTS

UNTIL recently the significance of section 21(5) of *The Bills of Exchange Act* has quite escaped us, we must confess. That section specifies that "where the payee is a fictitious or non-existing person, the bill may be treated as payable to bearer". We did not suppose that many cheques would really be made payable to Santa Claus, and we thought the whole point rather academic. Now a new light has burst upon us. The point is, we learn, that if the instrument is made payable to a fictitious or non-existing person, and the endorsement of that person is forged by way of negotiating the instrument for value, *the party liable cannot set up the real defence of forgery*. He must pay the instrument if the plaintiff is a holder in due course. From the point of view of the party liable there cannot be such a thing as a forged endorsement on an instrument of his which, at the time of endorsement, was payable to bearer.

The Bankers' Magazine of Australasia for July 1949 cites the following cases in which the point has been material.

In *Clutton v. Attenborough* (1897) Piper, a clerk of Clutton's, fraudulently obtained his employer's signatures to order cheques in favour of one George Brett, who did not exist as far as Clutton's were concerned, but who was represented by the clerk to have done work for Clutton. Piper endorsed the cheques "George Brett" and received value for them from Attenborough and Son, who were pawnbrokers.

It was held by the House of Lords that the payee was a fictitious or non-existing person and that the cheques could therefore be treated as payable to bearer, and that Attenboroughs were entitled to the proceeds of the cheques. The fact that there probably were in the world several people called George Brett was beside the point; there was no "George Brett" among the creditors of Clutton.

As part of his judgment Lord Shand said, "These cheques were in favour of a person of the name of Brett — he was fictitious because that name had been provided by a person who wishes to commit a fraud and to appropriate the money of his employer. He knew of no person of that name, and, in the language of the statute, I think these were, therefore, cheques in favour of a fictitious and a non-existing person There is no limitation in the language of the statute of the effect of the insertion of the name of the fictitious or non-existing person as payee of the cheque to the case where this is done in the knowledge of the drawer, and nothing to warrant a judicial interpretation of the statute in this limited way."

In *Vagliano Bros. v. Bank of England* (1891) the meaning of a fictitious person was held to include a real person who never had nor was intended to have any rights in the instrument. "A", a clerk in the employ of Vagliano Bros., forged the signature of "B" to bills drawn on Vagliano's payable to "C".

Both "B" and "C" were known to Vagliano's but the transactions were not genuine. The bills, although purporting to be drawn by an existing person "B" were in fact signed by "A" the fraudulent clerk and there was thus never any real intention that "C", although also an existing person, was to receive the money. Nevertheless Vagliano's accepted the bills and could not deny their acceptance to the Bank of England who duly paid the bills when "A", in perpetrating his fraud, signed "C's" name as endorser.

In this case Lord Herschell said, "I have arrived at the conclusion that whenever the name inserted as that of the payee is so inserted by way of pretence merely, without any intention that payment shall only be made in conformity therewith, the payee is a fictitious person within the meaning of the Statute, whether the name be that of an existing person, or of one who has no existence, and that the bill may, in each case, be treated by the lawful holder as payable to bearer."

CORRESPONDENCE

Kingston, Ont.

Sir: I note that Problem 1, Intermediate examination of November 1949 as printed in your November 1950 issue requires a balance sheet and statement of profit and loss "in conformity with the requirements of the *Dominion Companies Act*".

I submit that the problem does not give sufficient information to permit compliance with the requirements and hence that the solution as printed does not comply adequately with the following requirements of the Act:

- (1) Section 112(2)(d) which requires a statement of "the basis of valuation adopted in respect of various sub-divisions" of the inventory
- (2) Section 112(5) which requires that the investment in a subsidiary company be shown separately "distinguishing shares and indebtedness"

(3) Section 112(2)(g) which requires disclosure re land, buildings and plant of "the basis of valuation, whether cost or otherwise"

(4) Section 112(1)(c) which requires the following disclosures for each surplus account (and not for earned surplus only): "... the amounts ... at the beginning of the financial period ... any changes in and balance remaining ..."

I think that this matter is of sufficient importance to justify publication of a warning to students that the solution published in your November 1950 issue does not constitute satisfactory minimum disclosure under the provisions of the *Dominion Companies Act*.

W. G. LEONARD, F.C.A.

PUZZLE

What if anything is wrong with the accountant's certificate reproduced below?

*Port Allen, La.,
Dec. 29, 1874*

"We, the undersigned, having been appointed a committee to audit the books of the treasurer of the Poydras fund, hereby certify that we have examined all his books

and accounts and find them correct in every particular.

"PETER (X) WASHINGTON
(his mark)

"GEORGE (X) STEPTOE
(his mark)"

(From *The Journal of Accountancy*,
August 1926, page 122)

Solution will appear in next month's issue

SOLUTION TO LAST MONTH'S PUZZLE

\$37,000. "There are only two significant digits in the divisor, 30; there can be no more than two in the answer."

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect of course the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Final Examination, November 1949

Accounting IV, Question 4 (20 marks)

On 1 Jan 1928, I. M. Dunn died and left a trust fund consisting solely of all outstanding shares of Dunn's Limited to his son, Will B. Dunn, as life tenant, with his grandson as remainder-man. At this date, the capital stock of Dunn's Limited (2500 shares at \$100) had a book and market value of \$500,000. On 3 June 1949, Dunn's Limited declared a cash dividend of 120% payable 3 July 1949 to shareholders of record 3rd June 1949.

On 15 June 1949, Will B. Dunn died. His records showed the following estate:

Cash in bank	\$ 7,000
5% note receivable including \$50 accrued interest	6,050
Shares in commercial companies	75,000
Dividends declared on these shares	800
6% mortgage receivable, including \$150 accrued interest	25,150
Real estate (apartment house)	38,500
Household effects	10,100
Dividend receivable from I. M. Dunn trust fund	300,000
Total	<u>\$462,600</u>

The executor's transactions from 15-30 June 1949 follow:

Cash receipts:

Dividends	\$ 2,000
5% note receivable	6,000
Interest accrued on note	62
Shares sold (inventoried at \$45,000)	43,500
6% mortgage sold	25,100
Interest accrued on mortgage	200
Sale of assets not inventoried	500
Real estate sold	40,000
	<u>\$117,362</u>

Cash disbursements:

Funeral expenses	\$ 700
Debts of Will B. Dunn	10,000
Bequests	15,500
Advances to widow	750
	<u>\$ 26,950</u>

Required:

Executor's statements of principal and income with supporting schedules.

A SOLUTION

STATEMENT OF EXECUTOR

IN ESTATE OF WILL B. DUNN, DIED 15 JUNE 1949

covering period 15-30 June 1949

AS TO PRINCIPAL

I charge myself with:

Assets at 15 June 1949.

Cash in bank	\$ 7,000	
5% note receivable and accrued interest	6,050	
Shares in commercial companies	75,000	
Dividends declared	800	
6% mortgage receivable & accrued interest	25,150	
Real estate	38,500	
Household effects	10,100	
Dividend receivable	300,000	\$462,600

Assets subsequently discovered	500	
Profit on sale of assets per Schedule A	1,600	464,700

I credit myself with:

Funeral expenses	700	
Debts paid	10,000	
Bequests	15,500	
Loss on realization of assets	1,500	27,700

leaving a balance of		<u>\$437,000</u>
----------------------------	--	------------------

which is made up as follows:

Cash in bank (per Schedule B)	96,900	
Shares in commercial companies	30,000	
Household effects	10,100	
Dividend receivable from I. M. Dunn trust	300,000	\$437,000

AS TO INCOME

I charge myself with:

Dividends	1,200	
Interest on notes receivable	12	
Interest on mortgage	50	1,262

I credit myself with:

Advance to Mrs. Dunn		750
----------------------------	--	-----

leaving a balance of		<u>\$ 512</u>
----------------------------	--	---------------

which is made up of cash in bank per Schedule B		<u>\$ 512</u>
---	--	---------------

SCHEDULE A
PROFIT AND LOSS ON REALIZATION OF ASSETS

	Value per Inventory	Profit	Loss	Realized
Shares in commercial companies	\$ 45,000		\$ 1,500	\$ 43,500
6% mortgage	25,000	\$ 100		25,100
Real estate	38,500	1,500		40,000
	<u>\$108,500</u>	<u>\$ 1,600</u>	<u>\$ 1,500</u>	<u>\$108,600</u>

SCHEDULE B
STATEMENT OF CASH RECEIPTS & EXPENDITURES

Receipts:	Total	Corpus	Income
Cash in bank 15 June 1949	\$ 7,000	\$ 7,000	
Dividends	2,000	800	\$ 1,200
5% note receivable and interest	6,062	6,050	12
Shares sold	43,500	43,500	
6% mortgage and interest	25,300	25,250	50
Assets not inventoried	500	500	
Real estate	40,000	40,000	
	<u>\$124,362</u>	<u>\$123,100</u>	<u>\$ 1,262</u>
Disbursements:			
Funeral expenses	\$ 700	\$ 700	
Debts	10,000	10,000	
Bequests	15,500	15,500	
Advance to Mrs. Dunn	750		750
Cash in bank 30 June 1949	97,412	96,900	512
	<u>\$124,362</u>	<u>\$123,100</u>	<u>\$ 1,262</u>

PROBLEM 2

Final Examination, November 1949

Accounting IV, Question 5 (25 marks)

The following information relates to the Slop E. Work Co. Ltd. in respect of the year ended 31 Dec 1948:

Accounts receivable, \$1,908,600. Includes mortgages receivable from employees, \$25,000 bearing interest at 4% per annum. All interest has been paid when due and credited to interest and discount. Accrued interest receivable on these mortgages as at the end of the year amounting to \$500 has been set up.

Accounts payable, \$842,700.

Bad debts are estimated as 1% of net sales. During 1948, bad debts previously written off were recovered in the amount of \$7,800, which was credited to bad debt expense.

Bonds payable, \$550,000, maturing \$50,000 on 1 Jan every year 1949 to 1959 inclusive, with interest at 5% per annum payable 30 June and 31 Dec each year. The bonds were issued on 1 Jan 1939 at 98, discount to be written off on the straight line basis over the life of the bonds.

Buildings. Late in 1947, buildings were erected at a cost of \$144,000 which was estimated to be 180% of the cost in 1937. The excess over the 1937 cost was therefore charged to suspense, and is to be written off over 4 years against cost of goods sold.

Cash on hand and in bank, \$523,400.

Common shares, no par value, 21,000 shares, \$1,050,000.

Cost of goods sold shows a debit balance of \$4,379,200. Inventories at cost, which was lower than market, as at 1 Jan 1948 (which were charged to this account) were: Raw materials \$503,000, goods in process \$9,000, finished goods, \$297,300.

Depreciation is to be charged at 15% of the balance in the machinery and equipment accounts and 10% of the balance in the buildings account at the end of the year.

Dividends declared and paid during the year on preferred shares, \$10,500.

General expenses, \$794,300.

Income taxes for the year may be calculated at the rate of 35%. During the year, payments of \$100,000 have been made on account of taxes, and an assessment has been received in respect of 1946 showing an over-payment of \$10,000.

Interest and discount shows a dr. balance of \$20,950. Bank exchange of \$300 has been charged to this account.

Inventories at the end of the year were valued on the basis of the average of cost and market calculated as follows:

	Cost	Market	Average
Raw materials	\$600,000	\$600,200	\$600,100
Work in Process	7,000		7,000
Finished goods	320,000	300,000	310,000

Land, \$300,000. No entry in this account during the year.

Machinery and equipment, \$1,410,000. The only entry in this account during the year is a credit of \$95,000, being the proceeds from the sale in January of a machine bought in June 1944 for \$100,000.

Notes receivable discounted, face value \$14,700, discount \$1,470. During the year, total discounts of \$7,300 on notes receivable have been charged to interest and discount. One note with face value of \$4,000 is expected to prove uncollectible.

Office equipment balance in account 1 Jan 1948, \$35,000. During 1948, a business machine was purchased for \$4,500, and cash discount of \$500 was credited to interest and discount account.

Patents, leaseholds, goodwill, etc. Shown on books at \$2. During 1948 a patent was sold for \$20,000 and the proceeds credited to sales. This patent had originally cost \$30,000 in 1945 and had been written off over the years 1945, 1946 and 1947.

Prepaid expenses, \$2,700, — includes insurance \$2,500 and utility deposits, \$200.

Purchase commitments of \$120,000 in respect of new machinery have been made, and set up as a debit to cost of goods sold and a credit to accounts payable. 10% of the amount of the commitments has been deposited with the vendor. The machinery will be delivered in the spring of 1949.

Reserve for bad debts shows a credit balance of \$450,000. No entry has been made in this account during 1948.

Reserve for depreciation shows a credit balance of \$825,000. No entry has been made in this account during 1948.

Reserve for future price decline in inventory was set up during 1948 by a charge of \$30,000 against cost of goods sold.

Sales, \$6,300,000, include sales orders of \$500,000 on which no delivery has been made, although deposits of \$50,000 have been received and credited to accounts receivable.

7% preferred shares, par value \$100, 3,000 shares, non-redeemable, cumulative preferred as to dividends only.

Suspense Account, dr.: \$48,000.

Required:

Work sheet showing a trial balance of the above items, adjustments which are deemed necessary, balance sheet items as at 31 Dec 1948, and profit and loss items for the year ended 31 Dec 1948, in accordance with generally accepted accounting practice.

(For solution see pp. 51-2)

Editor's Note; (a) The solution appears to contain the following assumptions:

- (1) Interest on bonds was not paid on December 31, 1948
- (2) Discount on bonds has already been amortized for 1948, and the amount charged to Interest and discount account
- (3) Additional provision was not necessary in respect of the \$4,000 note receivable which was expected to prove uncollectible.

(b) It also appears from the problem itself that when notice of the 1946 tax overpayment was received during 1948, Surplus account must have been credited at that time.

A SOLUTION
SLOP E. WORK CO. LTD.
WORK SHEET — 31 DEC 1948

	Trial Balance		Adjustments		Profit and Loss		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Accounts receivable	1908,600		50,000 (12)	500,000 (2)			1433,600	
Mortgages receivable — employees				25,000 (1)				
Accounts payable		842,700	25,000 (1)				25,000	734,700
Bad debts expense		7,800	108,000 (9)					
Bonds payable		550,000	57,800 (4)		50,000			550,000
Bond discount unamortized	5,500						5,500	
Buildings	80,000		64,000 (5)				144,000	
Cash on hand and in bank	523,400						523,400	
Common shares — no par value		1050,000						1050,000
Cost of goods sold	4379,200		10,100 (6)	30,000 (14)				
				16,000 (5)				
				120,000 (9)	4223,300			
Depreciation			216,600 (11)					
			14,400 (10)		231,000			
Dividends — preferred	10,500							
General expenses	794,300							
Income taxes	100,000			10,500 (13)	794,300			
Income tax re 1946 assessment	10,000			156,363 (15)				46,363
Interest and discount	20,950							
			500 (8)					
			13,750 (12)					
Inventories	917,100				35,200			
Land	300,000			10,100 (6)			907,000	
Machinery and Equipment	1410,000			5,000 (7)			300,000	
Office equipment	39,500			500 (8)			1405,000	
							39,000	

The Students' Department

SLOP E. WORK CO. LTD.

WORK SHEET — 31 DEC 1948

	Trial Balance		Adjustments		Profit and Loss		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Patents, leaseholds, goodwill							2	
Profit on sale of patent								20,000
Prepaid expenses	2,700						2,700	
Deposit on new machinery		450,000	12,000 (9)				12,000	
Reserve for bad debts		825,000	60,000 (7)					507,800
Reserve for depreciation				14,400 (10)				996,000
Reserve for future inventory decline		30,000						30,000
Sales		6300,000	20,000 (3)					
			500,000 (2)		5780,000			
Customers' advances				50,000 (12)				50,000
7% preferred shares 100 par value		300,000						300,000
Suspense	48,000							
Accrued interest receivable	500			48,000 (5)		500		
Profit on sale of machine				55,000 (7)	55,000			
Accrued interest on bonds				13,750 (12)			13,750	
Surplus		194,752						154,252
			30,000 (14)					
			10,500 (13)					
			156,363 (15)		156,363			
Taxes on income								
	10550,252	10550,252	1349,013	1349,013	5490,163	5855,000	4797,702	4432,865
Net profit for year					364,837			364,837
					5855,000	5855,000	4797,702	4797,702

Never such a machine at any price
...and the price is surprisingly low!



BURROUGHS SENSIMATIC the completely new accounting machine!

Never such a machine at any price—that's what thousands of users tell us! And until you have actually seen how its "mechanical brain" directs the Sensimatic through various accounting operations, it's hard to believe any machine could be so versatile. Until you have actually watched an operator whisk through her work, it's hard to believe any machine could be so fast, so easy to operate.

Until you have heard what the Sensimatic is doing for other businesses... until you have learned its surprisingly low price... until you have seen it applied to *your* figuring problems—you can't know how much time and money a Sensimatic can save.

Call your Burroughs man for a demonstration today. Burroughs Adding Machine of Canada, Limited, Windsor, Ontario.

WHEREVER THERE'S BUSINESS THERE'S **Burroughs**



Employers...

ABOUT YOUR PENSION PROBLEMS

Today progressive employers realize the necessity of a properly designed Pension Plan for their employees.

The Standard Life places at your disposal the experience gained in underwriting Pension and Life Assurance Plans throughout the world.

During the last few years some 300 Canadian firms have taken advantage of the facilities provided by the Standard.

Why not consult the Standard about your Employee Benefit problems? All inquiries will be treated in strict confidence.

THE **STANDARD LIFE** ASSURANCE COMPANY

The Pioneer of Life Assurance in Canada

Head Office for Canada:

1245 Sherbrooke Street West, Montreal

Branches in Halifax • Saint John • Fredericton • Montreal • Ottawa
Toronto • Hamilton • London • Vancouver

